UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

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| In re ENRON CORPORATION SECURITIES LITIGATION | Civil Action No. H-01-3624 **(Consolidated)** |
| | CLASS ACTION |
| This Document Relates To: | |
| MARK NEWBY, et al., Individually and On Behalf of All Others Similarly Situated, Plaintiffs, | |
| vs. | |
| ENRON CORP., et al., Defendants. | |
| THE REGENTS OF THE UNIVERSITY OF CALIFORNIA, et al., Individually and On Behalf of All Others Similarly Situated, Plaintiffs, | |
| vs. | |
| KENNETH L. LAY, et al., Defendants. | |

**MEMORANDUM OF POINTS AND AUTHORITIES IN OPPOSITION TO MOTION TO DISMISS BY BARCLAYS PLC**

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## I. INTRODUCTION AND FACTUAL OVERVIEW[1]

In the face of a 500-page complaint alleging the largest and worst securities fraud in the history of the United States[2] in excruciating detail, every single defendant – Enron's insiders, Enron's directors, Enron's accountants, Enron's lawyers, and Enron's bankers have moved to dismiss. Some claim it is too detailed. Some claim it is not detailed enough. Everyone denies responsibility and not one defendant has seen fit to answer. Every defendant seeks to avoid accountability by raising technical pleading arguments based on the Private Securities Litigation Reform Act of 1995 ("95 Act") which was meant to deter the filing of ***frivolous*** suits – which everyone knows, except apparently the defendants, this case is not. While it does appear that the 95 Act was successful, at least in this case, in deterring plaintiffs' securities lawyers from filing cookie-cutter complaints, it does not appear to have the same salutary impact with respect to deterring defendants from filing meritless motions to dismiss.[3]

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1 Because any changes to the pleading requirements were not intended to prevent aggrieved parties from obtaining redress for their valid claims, "courts still apply Rule 12(b)(6) principles to motions to dismiss securities class action cases." *In re Boeing Sec. Litig.*, 40 F. Supp. 2d 1160, 1166 (W.D. Wash. 1998) (collecting cases); *see also Bryant v. Avado Brands, Inc.*, 187 F.3d 1271, 1273 n.1 (11th Cir. 1999). Consequently, the court must accept as true all well-pleaded allegations in the complaint and construe them in the light most favorable to plaintiff. *Scheuer v. Rhodes*, 416 U.S. 232 (1974); *Calliott v. HFS, Inc.*, No. 3:97-CV-0924-I, 2000 U.S. Dist. LEXIS 4368, at *8 (N.D. Tex. Mar. 31, 2000); *Zuckerman v. Foxmeyer Health Corp.*, 4 F. Supp. 2d 618, 621 (N.D. Tex. 1998) (Maloney, J.) (stressing that "the complaint is to be liberally construed in favor of the plaintiff"); *Young v. Nationwide Life Ins. Co.*, 2 F. Supp. 2d 914, 919 (S.D. Tex. 1998); *Lawal v. British Airways, PLC*, 812 F. Supp. 713, 716 (S.D. Tex. 1992). "A motion to dismiss for failure to state a claim under Fed. R. Civ. P. 12(b)(6) 'is viewed with disfavor and is rarely granted.'" *Calliott*, 2000 U.S. Dist. LEXIS 4368, at *7 (unless otherwise noted, all emphasis is added, and footnotes and citations are omitted). Dismissal is appropriate only if it appears that no relief could be granted under any set of facts that could be proven consistent with the allegations. *Rubinstein v. Collins*, 20 F.3d 160, 166 (5th Cir. 1994) (citing *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957)); *Tuchman v. DSC Communs. Corp.*, 818 F. Supp. 971, 974 (N.D. Tex. 1993), *aff'd*, 14 F.3d 1061 (5th Cir. 1994); *Calliott*, 2000 U.S. Dist. LEXIS 4368, at *3.

2 *See* John C. Coffee, "Guarding the Gatekeepers," *The New York Times*, 5/13/02, referring to Enron as a "[m]ajor debacle of historic dimensions."

3 While the banks all proclaim their innocence and insist that they acted properly, without conflict or corruption, and in accordance with normal commercial lending and investment banking activities, these denials ring hollow in light of the recent revelations of corruption on Wall Street. *See* Marcia Vickers & Mike France, "Wall St: How Corrupt is it?," 5/13/02 *Business Week*, attached as Ex. 1 to plaintiffs' Appendix.

If it is "irrational" to engage in acts that violate the law, then it appears Wall Street is deranged. However, if it is irrational to violate the law because of the risk of financial loss and

Barclays[4] portrays itself as a victim of the Enron debacle – a financial institution that was merely rendering "ordinary" banking services to Enron when it became engulfed in the Enron conflagration. But this is not what is pleaded in the CC and what is pleaded is what controls in the motion to dismiss context. What the CC pleads and what now must be accepted as true is that Barclays is liable under the 1934 Act[5] because it (i) employed acts, devices and contrivances to deceive; and (ii) participated in a scheme to defraud and a course of business that operated as a fraud or deceit on, purchasers of Enron's securities between 10/18/98 and 11/27/01 (the "Class Period").

### A. Year-End 97 Crisis

The fraudulent scheme and course of business involving Enron finds its origin in mid-97 when Enron suffered huge losses on British natural gas and MTBE transactions which called into question its trading and financial risk management statistics. Analysts downgraded Enron's stock and lowered their forecasts of Enron's future earnings growth. Enron's stock lost one-third of its value and Enron's executives' performance-based bonuses were slashed. Enron was determined to halt its stock's decline and push it back to higher levels. Enron knew this could only be accomplished by reporting stronger-than-expected financial results, thus enabling it to credibly

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punishment that accompanies illegal conduct then presumably no one would ever violate the law and acceptance of this after-the-fact rationale would provide all wrong doers from embezzlers to bank robbers to price fixers and sophisticated securities violators with a built-in defense.

Plaintiffs apologize for the length and repetition involved in responding to motions to dismiss filed by each of the nine banks sued as defendants. However, since the banks insisted, as was their right, to move to dismiss separately and because they have chosen to either ignore or grossly mischaracterize the allegations against them in the 500-page Consolidated Complaint ("CC") – apparently in the hope that the Court will not be able to find and focus on those allegations – plaintiffs had no choice but to respond separately as to each of the banks and set forth in detail the ***actual*** allegations made against the banks in the CC. After all, plaintiffs are entitled to have the adequacy of their CC against the banks determined based on the ***actual allegations*** of the CC, not defendants' mischaracterization of them.

[4] Barclays is an integrated financial services institution that through subsidiaries and divisions (such as Barclays Capital), provides commercial and investment banking services and advisory services, including acting as underwriter in the sale of corporate securities and providing investment analysis and opinions on public companies. ¶106.

[5] 15 U.S.C. §78a, *et seq.*

forecast stronger future earnings growth. Unfortunately, Enron's actual business operations were not capable of generating such results. ¶8.[6]

To make matters worse, in late 12/97, Enron learned that an entity it had established with an outside investor – Joint Energy Development Incorporated ("JEDI") – and had done transactions with to generate 40% of the profits Enron reported during 97 – had to be restructured, as the outside investor was going to withdraw from JEDI. This created a crisis. Because the outside investor in JEDI had been independent of Enron, JEDI had ***not*** been consolidated into Enron's financial statements, *i.e.*, Enron did deals with JEDI as an independent party, recognized profits and did not carry JEDI's debt on its books. Thus, unless JEDI could be quickly restructured with a new, independent investor, ***Enron would have to wipe out all of the profitable transactions it had done with JEDI in 97 – put JEDI's $700 million debt on Enron's balance sheet – and lose the ability to generate profits from similar such deals with JEDI's successor going forward.*** ¶9.

However, Enron ***could not find a legitimate buyer for the outside investor's interest*** in JEDI. So Enron and Barclays quickly formed Chewco, which Barclays, Enron and an Enron executive (Michael J. Kopper ("Kopper")) controlled, to buy the outside investor's interest in JEDI. ***Barclays loaned $240 million to Chewco to enable it to buy the outside investors' interest in JEDI, but required a secret guarantee of repayment from Enron. Barclays also loaned the money to two straw parties to provide for their purported "equity" investment in Chewco. Because Barclays knew that the purported equity investors in Chewco were, in fact, Enron "strawmen" Barclays required Enron and Chewco to support the purported "equity loans" Barclays made to the two "strawmen," via a $6.6 million reserve paid to Barclays***! ***Chewco thus did not have an outside equity investor which was an independent third party.*** This transaction was nothing more than a deceptive device and contrivance to deceive which falsified Enron's financial results and thus investors. Because there was no independent outside investor in Chewco, Chewco/JEDI was required to have been consolidated with Enron and ***all of Enron's 97 profits from transactions with JEDI should have been eliminated***! ¶10.

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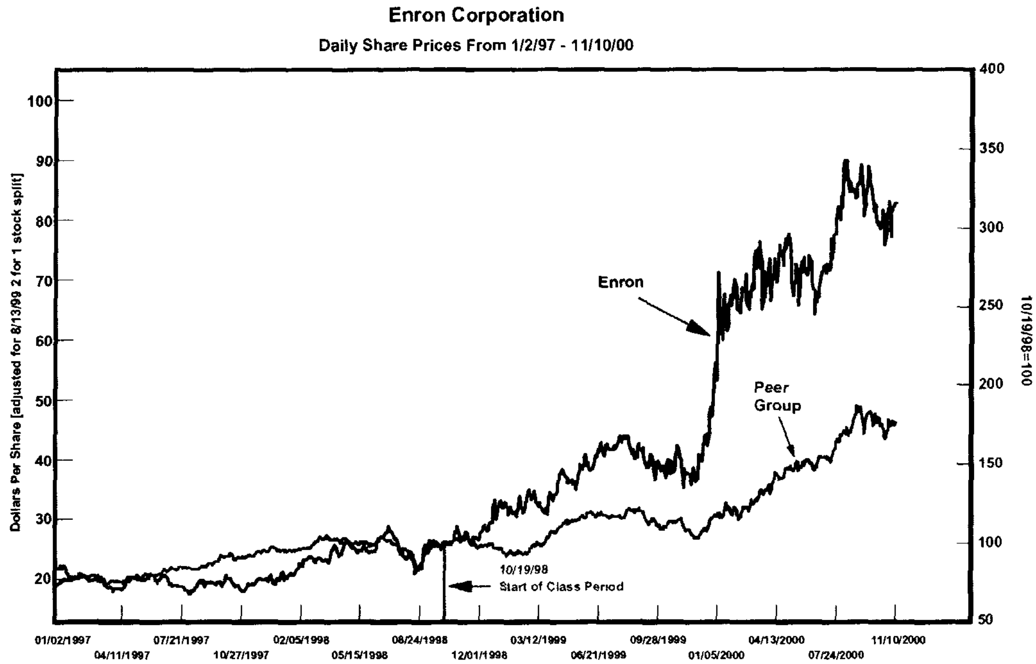
6 All "¶_" references are to plaintiffs' CC filed 4/8/02.

The Chewco contrivance and deception avoided a disaster for Enron by keeping the previously recorded JEDI profits in place, inflating Enron's 97 reported profits and keeping millions of dollars of debt off its books. Even more importantly, Chewco was now also positioned to serve as a controlled entity which Enron and Barclays could use to do non-arm's-length transactions with going forward, ***creating at least $350 million in phony profits for Enron and allowing Enron to conceal millions of dollars of debt – with Barclays active participation now including $500 million in loans to JEDI to help fund more and made bogus non-arm's length deals with Enron or SPEs***. ¶11.

**B. The 97-00 Successes – Enron's Stock Soars**

As Enron reported ***better-than-expected year-end 97 financial results***, its stock moved higher. During 98 through mid-01, Enron appeared to evolve into an enormously profitable high-growth enterprise, reaching annual revenues of $100 billion by 00, with annual profits of $1.2 billion, presenting a very strong balance sheet that entitled it to an ***investment grade credit rating***. By 01, Enron had become the 7th largest U.S. corporation and was consistently reporting ***higher-than-forecasted earnings each quarter*** and forecasting ***continued strong growth***. ¶12. Enron extolled the success and earning power of its Wholesale Energy trading business ("WEOS"), its Retail Energy Services business ("EES") and its Broadband Content Delivery and Access Trading, *i.e.*, intermediation, business ("EBS"). ¶2.

As a result of Enron's strong earnings, the positive statements about its business and the forecasts of continuing strong earnings growth, Enron's stock was a very strong performer and its debt securities also traded at high prices. ¶15. Enron's apparent success and forecasts of strong profit growth gave Enron and its bankers ready access to the capital markets by which they raised billions of dollars by selling newly issued Enron securities to public investors, using the proceeds to repay Enron's bank debt. ¶16. Enron's stock soared to its all-time high of $90-3/4 in 8/00 and then continued to trade at or near these levels for months, as shown below (¶15):




However, the apparent success of Enron was an illusion – a false picture created by manipulative or deceptive devices and contrivances – a fraudulent scheme and course of business by defendants that operated as a fraud and deceit on the purchasers of Enron's publicly traded securities. The fraudulent scheme was accomplished by, *inter alia*, Enron and several banks, including Barclays, which pocketed millions of dollars a year from Enron – which by 97-98 had become the ***golden goose of Wall Street***. ¶17.

Inside Enron there was a fixation on Enron's stock and doing whatever was required to generate the financial results necessary to push the stock ever higher. Throughout Enron's corporate headquarters in Houston were TV monitors that displayed the price of Enron stock. Inside Enron there was a saying that managers were to be "***ABC***ing," meaning to "***a***lways ***b***e ***c***losing" deals to generate revenues and profits, even if the economics of the deal were suspect – a practice facilitated by a compensation system inside Enron for corporate managers and executives that directly rewarded them financially for ***closing*** transactions and placing a high (*i.e.*, inflated) value on them, regardless of the true economic substance of the deal, so long as the deal generated an apparent profit when "marked to market." ¶50.

Inside Enron, the pressures applied to corporate managers by the top executives to do anything necessary to enable Enron to make its numbers was widespread, as was the knowledge that Enron's revenues and earnings were being falsified. Former insiders have been quoted as saying "***[y]ou don't object to anything***" and "***[t]he whole culture at the vice-president level and above just became a yes-man culture.***"

> But that culture had a negative side beyond the inbred arrogance. ***Greed was evident, even in the early days. "More than anywhere else, they talked about how much money we would make," says someone who worked for Skilling. Compensation plans often seemed oriented toward enriching executives rather than generating profits for shareholders. For instance, in Enron's*** energy services division, which managed the energy needs of large companies like Eli Lilly, executives were compensated based on a market valuation formula that relied ***on internal estimates. As a result, says one former executive, there was pressure to, in effect, inflate the value of the contracts – even though it had no impact on the actual cash that was generated.***

*Fortune*, 12/24/01 (¶51).

> ***"If your boss was [fudging], and you have never worked anywhere else, you just assume that everybody fudges earnings," says one young Enron control person. "Once you get there and you realized how it was, do you stand up and lose your job? It was scary. It was easy to get into 'Well, everybody else is doing it, so maybe it isn't so bad.'"***
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> *  *  *
>
> ***The flaw only grew more pronounced as Enron struggled to meet the wildly optimistic expectations for growth it had set for itself. "You've got someone at the top saying the stock price is the most important thing, which is driven by earnings," says one insider. "Whoever could provide earnings quickly would be promoted."***
>
> ***The employee adds that anyone who questioned suspect deals quickly learned to accept assurances of outside lawyers and accountants. She says there was little scrutiny of whether the earnings were real or how they were booked. The more people pushed the envelope with aggressive accounting, she says, the harder they would have to push the next year. "It's like being a heroin junkie," she said. "How do you go cold turkey?"***

*Business Week*, 2/25/02 (¶51). In fact, in mid-8/01, an Enron executive (who was a former Andersen accountant) wrote defendant Lay, telling him the Company was "***nothing but an elaborate accounting hoax***," and, in referring to the SPE transactions which Enron's banks – including Barclays – had structured and funded, that nothing "***will protect Enron if these transactions are ever disclosed in the bright light of day***" – warning "***[W]e're such a crooked company.***" ¶51.

By 97-98, Enron was a hall of mirrors inside a house of cards – reporting hundreds of millions of dollars of phony profits, while concealing billions of dollars of debt that should have been on its balance sheet – inflating its shareholder equity by billions of dollars. Enron had turned into the largest Ponzi scheme in history – constantly raising fresh money by selling its securities or those of related entities, while appearing to achieve successful growth and profits. But, because Enron's reported profits were being generated by phony, non-arm's-length transactions and improper accounting tricks – including the abuse of "mark-to-market" accounting[7] to accelerate the recognition of hundreds of millions of dollars of profits to ***current periods*** from transactions in which Enron was only entitled to receive ***cash over many future years*** – Enron was cash starved. Yet to continue to report ***growing*** profits, Enron was forced to not only continue to engage in such transactions and accounting abuses, ***but to accelerate the number and size of such transactions it engaged in***. This created a vicious cycle further exacerbating Enron's need to obtain cash from these transactions. ¶18.[8]

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[7] Enron engaged in several accounting tricks and manipulations to falsify its financial results during the Class Period. Chief among these was the abuse of "***mark-to-market accounting***," whereby Enron computed the purported profit it would ultimately obtain on a multi-year contract, discount that to present value and recognize the entire "mark-to-market" profit in the current period. Enron misused and abused mark-to-market accounting ***throughout its entire business to grossly inflate its reported revenues and profits***. In Enron's WEOS business this was done by assigning unrealistic values to wholesale energy transactions which inflated current period income. In Enron's EES business where Enron had no long-term track record to justify the use of mark-to-market accounting, Enron nevertheless consistently utilized mark-to-market accounting to record huge current period profits on long-term, highly speculative retail energy risk-management contracts which, in fact, Enron had no basis to project a profit on and in fact knew would likely result in losses. Finally, in Enron's EBS business – also a new business where Enron had absolutely no track record which would justify the use of mark-to-market accounting – Enron utilized mark-to-market accounting to generate hundreds of millions of dollars of phony current period profits in several transactions. Also, when reviewing those computations on a quarterly basis as it was required to do, Enron consistently ***increased*** the estimated value of the transaction even though subsequent data revealed ***a reduction of the estimated value of the transaction, a practice known within Enron as "moving the curve."*** ¶36.

[8] Enron's investment grade credit rating was indispensable. As Enron's CFO stated in a 10/01 conference call, "***We understand that our credit rating is critical to both the capital markets as well as our counterparties.***" Earlier, defendant Fastow stated to *CFO Magazine*, "***My credit rating is strategically critical.***" This investment grade credit rating gave Enron access to the commercial paper market – a market reserved for America's largest and most creditworthy corporations – so that it could borrow billions of dollars to maintain its liquidity and finance its capital-intensive business. Enron's access to the commercial paper market also meant that Enron's $3 billion commercial paper back-up credit line, arranged by the lead banks (J.P. Morgan and CitiGroup) with Barclays participating, ***would likely not be drawn down upon***, thus limiting those banks' financial exposure

***Enron became completely dependent on maintaining its investment grade credit rating so that Enron could continue to have access to the capital markets to borrow billions in commercial paper and to enable it to periodically raise hundreds of millions of dollars of new longer term capital it needed to repay its commercial paper debt and the short-term loans it was receiving from its banks – including Barclays***. ¶20.

### C. The Partnerships and SPEs

To falsify Enron's reported financial condition and results, Enron and Barclays engaged in a series of purported "partnership" and "related party" transactions with the entities known as SPEs. A public company that conducts business with an SPE may treat that SPE as if it were an independent entity ***only*** if it does not control the SPE. ***And***, at a bare minimum, two other conditions must be met: (i) an owner independent of the company must make an equity investment of ***at least 3% of the SPE's assets, which must remain at risk throughout the transaction***; and (ii) ***the independent party must exercise control of the SPE***. ¶21.

One of the key vehicles used to falsify Enron's financial results was Chewco/JEDI, which was secretly controlled by Enron and used to fund numerous SPEs, which were then used to engage in transactions to artificially inflate Enron's profits while concealing billions of dollars in its debt. ¶22. During 97-01, Enron entered into numerous transactions with Chewco/JEDI, including selling assets to them that it wanted to get off its books on terms that no independent third party would ever have agreed to.

### D. Enron's Access to the Capital Markets

Enron required constant access to huge amounts of capital. For Enron to continue to appear to succeed it had to keep its investment grade credit rating and keep its stock price high. Enron's investment grade credit rating and high stock price could ***only*** be maintained by: (i) limiting the amount of debt shown on Enron's balance sheet; (ii) reporting strong current period earnings; ***and***

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to Enron. It also meant that Enron and its banks could easily sell debt securities to investors to raise long-term capital, using the proceeds to reduce short-term commercial paper and other bank debt. Enron's investment grade credit rating was critical to the scheme, as only Enron's insiders and its banks knew, because under the terms of the partnership/SPE deals, ***if Enron's debt was downgraded to below investment grade, the debt of those entities would become recourse to Enron, which could cause the house of cards to topple***. ¶19.

(iii) forecasting strong future revenue and earnings growth. Yet Enron was able to achieve these ends only by pursuing an increasing number of phony transactions, many of which were accomplished by increasing the number and size of transaction entities which were supposedly independent of Enron but which, in fact, Enron controlled through a series of secret understandings and illicit financing arrangements, including the Chewco. As a result of reporting strong earnings, the apparent success of its business and its future earnings growth forecasts, Enron had unlimited access to the capital markets, borrowing billions of dollars in the commercial paper markets and by selling billions of dollars of Enron securities to the public. Enron and its bankers – ***including Barclays*** – raised at least $10 billion in new debt and equity capital from public investors through numerous securities offerings, thus raising the capital necessary to allow Enron to repay or pay down its short-term debt and continue to operate while associated entities. ***Barclays helped Enron raise critically needed capital in 2/01 via a gargantuan $1.9 billion 0% convertible note offering***. ¶48. Without this funding the fraudulent scheme could not have continued.

**E. The Impending Collapse**

By the Summer of 01, Enron realized that it would not be able to continue to sustain the illusion of strong profitable growth much longer and that it would have to take large write-offs in the second half of 01 that, in turn, could result in a downgrade of Enron's critical investment grade credit rating – an event that they knew would mean that debt on the books of the SPEs Enron did business with (and partnerships controlled by them), which debt Enron had assured investors was "***non-recourse***" to Enron would, in fact, become Enron's obligation. ¶55.

On 8/14/01, Enron announced that Skilling – who had become Enron's CEO just months earlier – was resigning, for "***personal reasons***." While this resignation fanned the controversy over the true nature of Enron's finances and the condition of Enron's business, Enron lied to investors, telling them that Skilling's resignation was only for personal reasons and did not raise "***any accounting or business issues of any kind***" and that Enron's financial condition "***had never been stronger***" and its "***future had never been brighter***." They said there was "***nothing to disclose***." ¶57.

## F. The End

By 8/01, inside Enron management employees were complaining to Enron's Board that the fraud at Enron was so widespread it was out of control. In 8/01, two employees complained to the Board (¶59):

A. One employee wrote:

> Skilling's abrupt departure will raise suspicions of accounting improprieties and valuation issues. Enron has been very aggressive in its accounting – most notably the Raptor transactions and the Condor vehicle. We do have valuation issues with our international assets and possibly some of our EES MTM positions.
>
> * * *
>
> We have recognized over $550 million of fair value gains on stock via our swaps with Raptor, much of that stock has declined significantly – Avici by 98%, from $178 mm to $5 mm. The New Power Co. by 70%, from $20/share to $6/share. The value in the swaps won't be there for Raptor, so once again Enron will issue stock to offset these losses. Raptor is an LJM entity. It sure looks to the layman on the street that we are hiding losses in a related company and will compensate that company with Enron stock in the future.
>
> ***I am incredibly nervous that we will implode in a wave of accounting scandals.... [T]he business world will consider the past successes as nothing but an elaborate accounting hoax****....*
>
> ***[W]e booked the Condor and Raptor deals in 1999 and 2000, we enjoyed a wonderfully high stock price, many executives sold stock, we then try and reverse or fix the deals in 2001 and it's a bit like robbing the bank in one year and trying to pay it back 2 years later. Nice try, but investors were hurt, they bought at $70 and $80/share looking for $120/share and now they're at $38 or worse***. We are under too much scrutiny and there are probably one or two disgruntled "redeployed" employees who know enough about the "funny" accounting to get us in trouble.
>
> * * *
>
> I realize that we have had a lot of smart people looking at this .... ***None of that will protect Enron if these transactions are ever disclosed in the bright light of day****.....*
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> * * *
>
> I firmly believe that the probability of discovery significantly increased with Skilling's shocking departure. Too many people are looking for a smoking gun.
>
> * * *
>
> 3. ***There is a veil of secrecy around LJM and Raptor. Employees question our accounting propriety consistently and constantly****....*
>
>    a. Jeff McMahon was highly vexed over the inherent conflicts of LJM. ***He complained mightily to Jeff Skilling*** .... 3 days later, Skilling offered him the CEO spot at Enron Industrial Markets ....

b. ***Cliff Baxter complained mightily to Skilling and all who would listen about the inappropriateness of our transactions with LJM.***

c. I have heard one manager level employee ... say "***I know it would be devastating to all of us, but I wish we would get caught. We're such a crooked company."... Many similar comments are made when you ask about these deals....***

B. A second employee wrote:

One can only surmise that the removal of Jeff Skilling was an action taken by the board to correct the wrong doings of the various management teams at Enron. However ... I'm sure the board has only scratched the surface of the impending problems that plague Enron at the moment. (*i.e.*, EES's ... hiding losses/SEC violations ... lack of product, etc.).

* * *

[I]t became obvious that EES had been doing deals for 2 years and was losing money on almost all the deals they had booked. (JC Penney being a $60MM loss alone, then Safeway, Albertson's, GAP, etc.). Some customers threatened to sue if EES didn't close the deal with a loss (Simon Properties – $8MM loss day one).... Overnight the product offerings evaporated.... Starwood is also mad since EES has not invested the $45MM in equipment under the agreement.... Now you will loose [sic] at least $45MM on the deal.... You should also check on the Safeway contract, Albertson's, IBM and the California contracts that are being negotiated.... It will add up to over $500MM that EES is losing and trying to hide in Wholesale. Rumor on the 7th floor is that it is closer to $1 Billion....

This is when they decided to merge the EES risk group with Wholesale to hide the $500MM in losses that EES was experiencing. But somehow EES, to everyone's amazement, reported earnings for the 2nd quarter. According to FAS 131 – Statement of Financial Accounting Standards (SFAS) #131, "Disclosures about Segments of an Enterprise and related information," EES has knowingly misrepresented EES' earnings. This is common knowledge among all the EES employees, and is actually joked about....

There are numerous operational problems with all the accounts.

* * *

... Some would say the house of cards are falling....

You are potentially facing Shareholder lawsuits, Employee lawsuits ... Heat from the Analysts and newspapers. The market has lost all confidence, and its obvious why.

You, the board have a big task at hand. You have to decide the moral, or ethical things to do, to right the wrongs of your various management teams.

* * *

... But all of the problems I have mentioned, they are very much common knowledge to hundreds of EES employees, past and present.

***On 10/16/01, Enron shocked the markets with revelations of $1.0 billion in charges and a reduction of shareholders' equity by $1.2 billion.*** Within days, *The Wall Street Journal* began an exposé of JEDI and Chewco, the SEC announced an investigation of Enron, and Fastow "resigned." ***In 11/01 Enron was forced to admit that Chewco was a fraud – an entity it controlled and because JEDI's non-consolidation depended on Chewco's status, JEDI was not independent either and so Enron consolidated Chewco/JEDI retroactive to 97. This retroactive consolidation resulted in a massive reduction in Enron's reported net income and massive increase in its reported debt.*** Enron restated its 97, 98, 99 and 00 financial results to eliminate $600 million in previously reported profits and approximately $1.2 billion in shareholders' equity as detailed below (¶61):

| ENRON ACCOUNTING RESTATEMENTS | | | | |
|---|---|---|---|---|
| | 1997 | 1998 | 1999 | 2000 |
| **Recurring Net Income** Amount of Overstatement | $ 96,000,000 | $113,000,000 | $250,000,000 | $ 132,000,000 |
| **Debt** Amount of Understatement | $711,000,000 | $561,000,000 | $685,000,000 | $ 628,000,000 |
| **Shareholders' Equity** Amount of Overstatement | $313,000,000 | $448,000,000 | $833,000,000 | $1,208,000,000 |

Chewco/JEDI were ***used by Enron and Barclays to enter into transactions that Enron could not, or would not, do with unrelated commercial entities***. The Chewco/JEDI transactions were designed ***to create phony profits or to improperly offset losses***. These transactions enabled Enron to conceal from the market ***very large losses resulting from Enron's merchant investments by creating an appearance that those investments were hedged – that is, that a third party was obligated to pay Enron the amount of those losses, when in fact that third party was simply an entity in which only Enron had a substantial economic stake***. ¶62. Chewco/JEDI was a deceptive device and contrivance to deceive investors in Enron.

By 11/28/01, Enron's publicly traded debt had been downgraded to "junk" status and on 12/2/01, Enron filed for bankruptcy – ***the largest bankruptcy in history***. Enron's stock and its publicly traded debt securities have suffered massive price declines, inflicting billions of dollars of losses on purchasers of those securities. ¶66.

As *Newsweek* has written:

> In the late 1990s, by my count, Enron lost about $2 billion on telecom capacity, $2 billion in water investments, $2 billion in a Brazilian utility and $1 billion on a controversial electricity plant in India. Enron's debt was soaring. If these harsh truths became obvious to outsiders, Enron's stock price would get clobbered – and a rising stock price was the company's be-all and end-all. Worse, what few people knew was that Enron had engaged in billions of dollars of off-balance-sheet deals that would come back to haunt the company if its stock price fell.

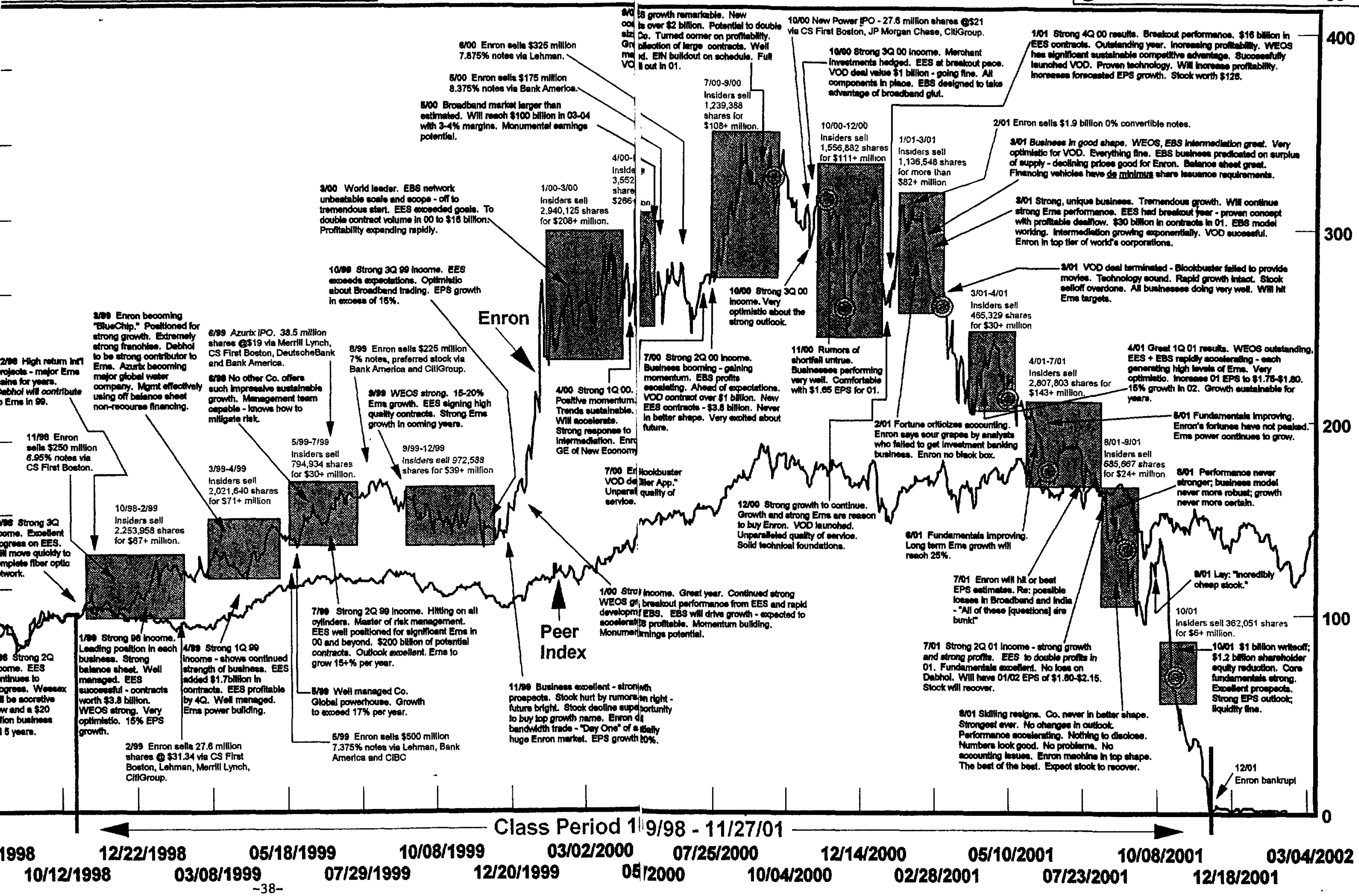
*Newsweek*, 1/21/02 (¶69).

> ***The key to the Enron mess is that the company was allowed to give misleading financial information to the world for years***. Those fictional figures, showing nicely rising profits, enable Enron to become the nation's seventh largest company, with $100 billion of annual revenues. Once accurate numbers started coming out in October, thanks to pressure from stockholders, lenders and the previously quiescent SEC, Enron was bankrupt in six weeks. The bottom line: we have to change the rules to make companies deathly afraid of producing dishonest numbers, and we have to make accountants mortally afraid of certifying them. Anything else is window dressing.

*Newsweek*, 1/28/02 (¶69). The rise and demise of Enron is graphically depicted below:

l Shares Sold By Defendants: 20,788,957 shares
endants' Insider Trading Proceeds: $1,190,479,472

# Enron Timeline
## 7/1/98 - 3/7/02



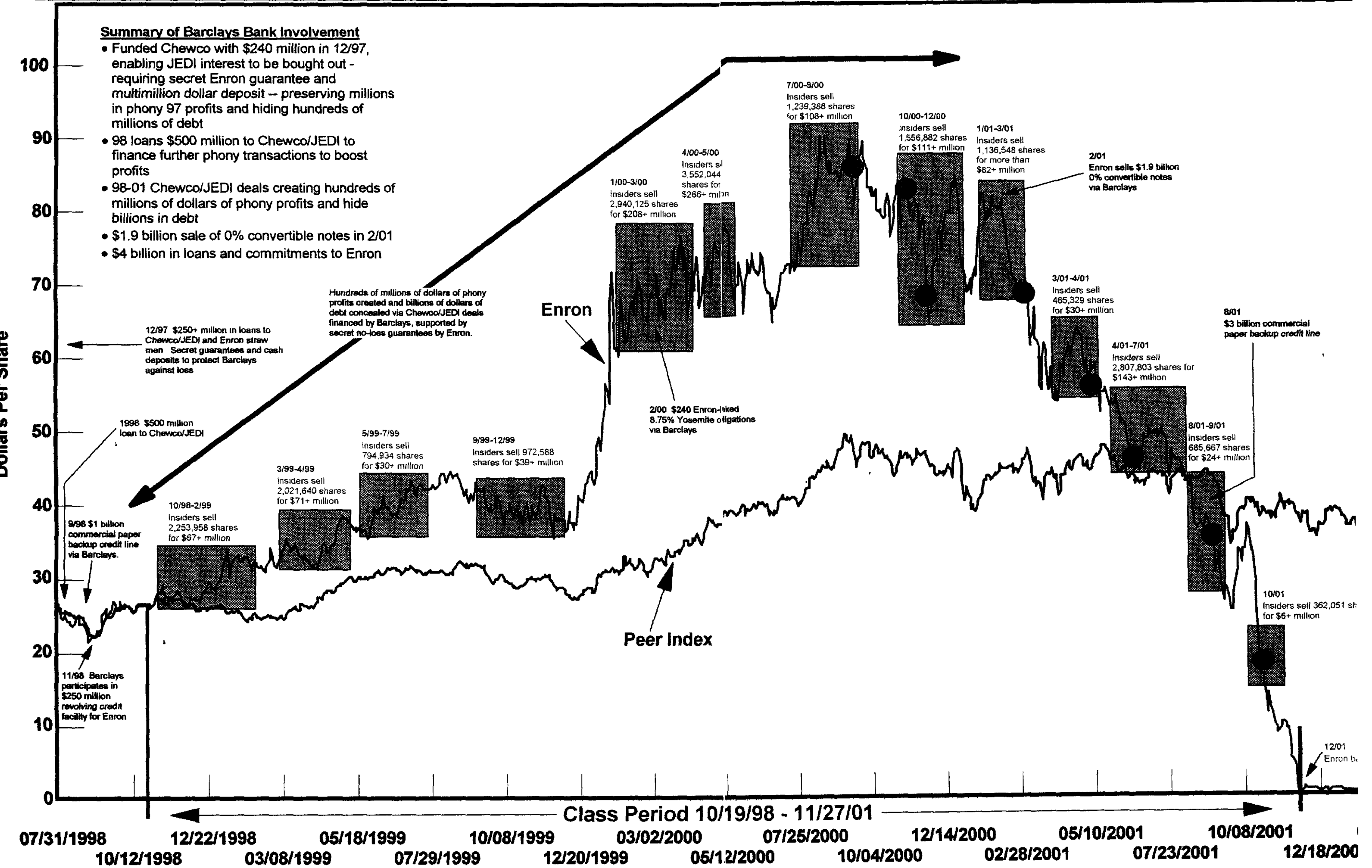
## II. SUMMARY OF BARCLAYS INVOLVEMENT AND LEGAL LIABILITY

Barclays had an extensive relationship with Enron, providing ***both*** commercial banking and investment banking services to Enron. Barclays helped structure and finance a key secretly-controlled partnership and fund its illicit transactions with Enron, thus helping Enron falsify its financial statements and misrepresent its financial condition from 97-01. In return for its participation in the scheme, Barclays received secret guarantees to protect it against loss while pocketing large underwriting and consulting fees, interest payments, commitment fees and other payments from Enron and related entities. *See* chart below:

Total Shares Sold By Defendants: 20,788,957 shares
Defendants' Insider Trading Proceeds: $1,190,479,472

# Enron Timeline -- Barcays Underwritings/Loans/Analyst Reports

7/31/98 - 3/7/02



To falsify Enron's financial condition and inflate its reported results, Enron and Barclays engaged in purported "partnership" and "related party" transactions. Many of the entities Enron used to falsify its financial results were known as SPEs. A public company that conducts business with an SPE may treat that SPE as if it were an independent entity ***only*** if it does not control the SPE. At a bare minimum, two conditions must be met: (i) an owner independent of the company must make an equity investment of ***at least 3% of the SPE's assets, and that 3% must remain at risk throughout the transaction***; and (ii) ***the independent owner must exercise control of the SPE***.

In late 97, Enron learned that an entity it had done transactions with to generate large amounts of the profits – JEDI – had to be restructured, as the outside investor was going to withdraw from JEDI. This situation created a crisis. Because of the involvement of the outside investor in JEDI, JEDI had been treated as independent of Enron and had ***not*** been consolidated into Enron's financial statements and results. Thus, Enron had been able to engage in transactions with JEDI as an independent third party, recognize revenue and profits from those transactions and not carry JEDI's debt on Enron's books. However, in late 97, unless JEDI could be quickly restructured by having a new, independent investor come forward, ***Enron would have to wipe out all of the profitable transactions it had done with JEDI in 97 – 40% of that year's profits – put JEDI's debt on Enron's balance sheet – some $700 million in debt – and lose the ability to generate profits from similar such deals with JEDI or its successor going forward.*** ¶9.

Enron ***could not find a legitimate buyer for the outside investor's interest*** in JEDI. So Lay, Skilling, Fastow and Barclays, formed Chewco, which Enron and Barclays controlled, to buy the outside investor's interest in JEDI. Chewco ***did not have an outside 3% equity investor – the minimum required to enable Chewco and JEDI to be treated as an independent third party. Barclays loaned some $240 million to Chewco, requiring a secret guarantee of repayment from Enron, so that Chewco would invest in JEDI, making it possible for transactions between JEDI and Enron to artificially inflate Enron's reported results. Barclays also loaned the money to two straw parties (Little River and Big River) to provide $11.4 million for the purported 3% "equity" investment in Chewco. Because Barclays knew that these purported equity investors in Chewco were, in fact, "strawmen" for Enron, Barclays required Chewco to support the purported "equity***

***loans" Barclays made to the two "strawmen" via a $6.6 million reserve paid to Barclays***! Because there was no legitimate independent outside investor in Chewco, Chewco was required to have been consolidated with Enron and ***all of Enron's 97 profits generated by transactions with JEDI would have been eliminated***! ¶10.

By forming and funding Chewco at year-end 97, Enron and Barclays avoided a disaster by keeping Enron's previously recorded and reported profits from transactions with JEDI in place, thus inflating Enron's 97 reported profits by $45 million. They also kept as much as $700 million worth of debt off Enron's books, making Enron look much more creditworthy and liquid than it actually was, deceiving investors. Even better, they had now positioned Chewco to serve as a controlled entity which Enron could use going forward to do non-arm's-length transactions with, creating phony profits for Enron ***(at least $350 million) and allowing Enron to conceal the true state of its indebtedness by improperly moving debt off its balance sheet and onto the books of Chewco during the next three years, as Barclays continued to fund this fraudulent vehicle being used to falsify Enron's financial results – including an additional $500 million loan to JEDI in 98***. ¶11. ***Chewco/JEDI was never a valid SPE meeting the requirements for non-consolidation. It was simply a contrivance – a deceptive device used by Enron and Barclays to falsify Enron's financial results – thus generating hundreds of millions of dollars of false profits from 97 through 01***. ¶22.

Barclays's funding in the Chewco/JEDI deal at year-end 97 and then funding JEDI thereafter to the tune of $500 million, ***while accepting secret guarantees from Enron and requiring secret cash deposits because it knew the transactions were non-arm's-length and fraudulent*** – was part of how Barclays employed acts, deceptive devices and contrivances to deceive and participated in a fraudulent scheme and course of business – disguising and thus concealing billions of dollars of Enron debt to provide hundreds of millions to finance Enron's secretly controlled partnership and its illicit transactions with Enron to falsify Enron's financial condition and reported profits – all of which artificially inflated the prices of Enron's publicly traded securities. This conduct is expressly prohibited by the language of §10(b) and Rule 10b-5.

According to the Supreme Court, §10(b)'s prohibition of "any ***manipulative or deceptive device or contrivance***" necessarily encompasses any "***scheme to defraud***." In *Ernst & Ernst v.*

*Hochfelder*, 425 U.S. 185 (1976), the Court referred to the ***dictionary definitions*** of §10(b)'s words, to find that a "device" is "'[t]hat which is devised, or formed by design; a contrivance; an invention; project; ***scheme; often, a scheme to deceive***; a stratagem; an artifice.'" *Id.* at 199 n.20 (quoting *Webster's International Dictionary* (2d ed. 1934)). The Court found that a "contrivance" means "'***a scheme, plan, or artifice***.'" *Id.* (quoting *Webster's International Dictionary*); *see also Aaron v. SEC*, 446 U.S. 680, 696 n.13 (1980). Thus, scheme liability ***is authorized by the text of §10(b)***. Rule 10b-5 – adopted by the SEC to implement §10(b) – accordingly, in addition to prohibiting false statements, Rule 10b-5 makes it unlawful for any person "***directly or indirectly***" to employ "***any*** device, ***scheme***, or artifice ***to defraud***" or to "***engage in any act, practice, or course of business which operates ... as a fraud or deceit upon any person***." 17 C.F.R. §240.10b-5. *See also U.S. Quest, Ltd. v. Kimmons*, 228 F.3d 399, 407 (5th Cir. 2000).

In *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972), the Court observed that "the second subparagraph of [Rule 10b-5] specifies the making of an untrue statement of a material fact and the omission to state a material fact," *id.* at 152-53, but held that "[t]he first and third subparagraphs ***are not so restricted***." *Id.* at 153. It held that the defendants violated Rule 10b-5 when they participated in "***a 'course of business' or a 'device, scheme, or artifice' that operated as a fraud***" – ***even though these defendants had never themselves said anything that was false or misleading***. *Id.*[9] "***Not every violation of the anti-fraud provisions of the federal securities law can be, or should be, forced into a category headed 'misrepresentations' or 'nondisclosures***.'" *Competitive Assocs., Inc. v. Laventhol, Krekstein, Horwath & Horwath*, 516 F.2d 811, 814 (2d Cir. 1975). "Fraudulent devices, practices, schemes, artifices and courses of business are also interdicted by the securities laws." *Id.*

[9] *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 11 n.7 (1971) ("'[We do not] think it sound to dismiss a complaint merely because the ***alleged scheme does not involve the type of fraud that is "usually associated with the sale or purchase of securities." We believe that §10 (b) and Rule 10b-5 prohibit all fraudulent schemes in connection with the purchase or sale of securities, whether the artifices employed involve a garden type variety of fraud, or present a unique form of deception. Novel or atypical methods should not provide immunity from the securities laws***.'") (quoting *A. T. Brod & Co. v. Perlow*, 375 F.2d 393, 397 (2d Cir. 1967)).

Thus, the Fifth Circuit sitting *en banc* held that a defendant who did not himself make the statements in a misleading offering circular could be held primarily liable ***as a participant in a larger scheme to defraud of which that offering circular was only a part: "Rather than containing the entire fraud, the Offering Circular was assertedly only one step in the course of an elaborate scheme.***" *Shores v. Sklar*, 647 F.2d 462, 468 (5th Cir. 1981). *See Finkel v. Docutel/Olivetti Corp.*, 817 F.2d 356, 363 (5th Cir. 1987) (complaint alleging manipulation of reported financial results by two public companies properly alleged a scheme to defraud or course of business operating as a fraud, the effect of which was to defraud purchases of Docutel securities in violation of 10b-5(1) and (3)).

The fraudulent scheme and course of business involving Enron ***was worldwide in scope, years in duration and unprecedented in scale***. Wrongdoing of this scope and on this scale could not have been accomplished solely by the efforts of Enron's executives, no matter how dishonest or determined they may have been. Wrongdoing of this scope and on this scale required the skills and active participation of lawyers, bankers and accountants. It could not have happened otherwise.

The notion that *Central Bank, N.A. v. First Interstate Bank, N.A.*, 511 U.S. 164 (1994), issued a broad edict that lawyers, banks and accountants are immune from liability for their participation in complex securities frauds is nonsense. *Central Bank* expressly recognized: "The absence of §10(b) aiding abetting liability ***does not mean that secondary actors in the securities markets are always free from liability under the securities Acts. Any person or entity, including a lawyer ... or bank, who employs a manipulative device[10] or makes a material misstatement (or omission) on which a purchaser ... relies[11] may be liable as a primary violator under 10b-5 .... In any complex securities fraud, moreover, there are likely to be multiple violators....***" *Id.* at 191. A scheme to

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[10] As pointed out earlier, the Court has previously held that §10(b)'s language "'any manipulative or deceptive device or contrivance'" includes a "scheme to deceive" or "scheme, plan, or artifice." *Hochfelder*, 425 U.S. at 197, 199 n.20.

[11] Because this action's 1934 Act claims are "fraud-on-the-market" claims, reliance is established, *i.e.*, presumed, based on the materiality of false representations to the market, subject to defendants' right to rebut that presumption. *Basic Inc. v. Levinson*, 485 U.S. 224, 247 (1988); *Summit Props. v. Hoechst Celanese Corp.*, 214 F.3d 556, 561 (5th Cir. 2000), *cert. denied*, 531 U.S. 1132 (2001); *Fine v. American Solar King Corp.*, 919 F.2d 290, 298 (5th Cir. 1990).

defraud often will involve a variety of actors, and investors are entitled to allege "***that a group of defendants acted together to violate the securities laws, as long as each defendant committed a manipulative or deceptive act in furtherance of the scheme.***" *Cooper v. Pickett*, 137 F.3d 616, 624 (9th Cir. 1998); *accord SEC v. First Jersey Sec. Litig.*, 101 F.3d 1450, 1471 (2d Cir. 1996).

*Central Bank* denied recovery to victims of an alleged securities fraud who pleaded ***only one theory of recovery*** against a bank defendant – "secondary" liability they dubbed "aiding and abetting." *Central Bank*, 511 U.S. at 188. However, neither the words aiding and abetting nor any other language encompassing aiding and abetting appear in §10(b) or Rule 10b-5. The Court said "***[T]he text of the 1934 Act does not itself reach those who aid and abet a §10(b) violation ... [and] that conclusion resolves the case.***" *Id.* at 177. The *Central Bank* plaintiffs did not, as the plaintiffs do here, plead or pursue recovery under the theory that the bank defendant (i) made false and misleading statements in Registration Statements where the bank acted as underwriter in selling securities or other documents the bank issued to the public, *e.g.*, analyst reports, ***or*** (ii) employed acts, manipulative or deceptive devices and contrivances, ***or*** (iii) engaged in a fraudulent scheme or course of business that operated as a fraud or deceit on purchasers of the securities in issue. In the words of the Court, the plaintiffs "***concede that Central Bank did not commit a manipulative or deceptive act within the meaning of §10(b).***" *Id.* at 191. Plaintiffs here make no such concessions. Thus, because the *Central Bank* plaintiffs made fatal concessions and pursued a theory of recovery which found ***no support in the text of either the statute or the rule, they lost.***

*Central Bank* cannot mean that a defendant cannot be liable under §10(b) unless the defendant itself made misleading statements because the Court later rejected that very argument in *United States v. O'Hagan*, 521 U.S. 642 (1997). The Eighth Circuit had held that, under *Central Bank*, "§10(b) covers ***only deceptive statements or omissions on which purchasers and sellers ... rely.***" *Id.* at 664. ***The Court reversed***, holding that §10(b) does not require a defendant to speak. *Id.* Because §10(b) prohibits "any manipulative or deceptive device or contrivance" in contravention of SEC rules, this reaches "any deceptive device," whether or not the defendant spoke. *Id.* at 650-51. *Superintendent of Ins.* is consistent with *O'Hagan*. In *Superintendent of Ins.*, a ***unanimous*** Court upheld a §10b/Rule10b-5 complaint involving a "fraudulent scheme" involving the sale of securities where ***no*** false statement was alleged because:

> ***There certainly was an "act" or "practice" within the meaning of Rule 10b-5 which operated as "a fraud or deceit" on Manhattan, the seller of the Government bonds.***

404 U.S. at 9.

This Court has repeatedly stated: "***A defendant need not have made a false or misleading statement to be liable.***" *In re Landry's Seafood Restaurants, Inc. Sec. Litig.*, No. H-99-1948, slip op. at 9 n.12 (S.D. Tex. Feb. 20, 2001); *In re Waste Mgmt., Inc. Sec. Litig.*, Civ. No. H-99-2183, slip. op. at 75 (S.D. Tex. Aug. 16, 2001);[12] *In re Sec. Litig. BMC Software, Inc.*, 183 F. Supp. 2d 860, 869 (S.D. Tex. 2001).[13] ***Thus, the fact that Barclays did not itself make any false statements – which is the lynch pin of its motion to dismiss – does not mean it is immune from §10(b)/Rule 10b-5 liability***. The "bright line" test for §10(b)/Rule 10-b-5 liability Barclays sees so clearly and relies so heavily on is a mirage. It does not exist.[14]

That this reading of §10(b)/Rule 10b-5 is clearly correct is shown by a new ***unanimous*** Supreme Court decision – *SEC v. Zandford*, __ U.S. __, No. 01-147, 2002 U.S. LEXIS 4023 (June 3, 2002). In *Zandford*, the Court repeatedly cited with approval its seminal "***fraudulent scheme***" case *Superintendent of Ins.*, and reversed dismissal of a §10(b)/Rule 10b-5 complaint making the following key points:

- "***The scope of Rule 10b-5 is coextensive with the coverage of §10(b)*** ...." *Id.* at *7 n.1.

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12 Due to the length of these opinions, and the fact that this Court has access to them, they have not been attached to this brief.

13 While the CC does not plead that Barclays issued false and misleading analysts reports on Enron, we believe Barclays did so and are attempting to locate these reports.

14 The fact that Barclays itself made no false statements ***does not*** mean that Barclays did not know that statements being made about its co-schemers were false and misleading. As discussed in the scienter section, Barclays knew or recklessly disregarded that statements being made by Enron, Andersen and other banks as part of the fraudulent scheme were false and misleading.

- ***"[N]either the SEC nor this Court has ever held that there must be a misrepre sentation about the value of a particular security" to violate §10(b).*** *Id.* at *13.[15]

- Allegations that defendant "'***engaged in a fraudulent scheme***'" or "'***course of business that operated as a fraud or deceit***'" stated a §10(b) claim. *Id.* at *13, *14-*17.

*Central Bank* clearly – ***but merely*** – stands for the proposition that no aiding and abetting liability exists under the 1934 Act because neither §10(b) nor Rule 10b-5 contain language encompassing "aiding and abetting." The decision in *Central Bank* is actually ***quite narrow***. By contrast, the language of §10(b) and Rule 10b-5 is ***very broad*** and the purposes of §10(b) and Rule 10b-5 are remedial, intended to provide access to federal court to persons victimized in fraudulent securities transactions:

> [T]he 1934 Act and its companion legislative enactments [including the 1933 Act] embrace a "fundamental purpose ... to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry...." Congress intended securities legislation enacted for the purpose of avoiding frauds to be construed "not technically and restrictively, but flexibly to effectuate its remedial purposes."

*Affiliated Ute*, 406 U.S. at 151. As noted by the Fifth Circuit:

> [T]he Court has concluded that the Exchange Act and the Securities Act should be ***construed broadly to effectuate the statutory policy affording extensive protection to the investing public***. *See Tcherepnin*, 389 U.S. at 336, 88 S. Ct. at 553. *See also* S. Rep. No. 47, 73d Cong. 1st Sess. 1 (1933) (***indicating legislative intent of the Securities Act to protect the public from the sale of fraudulent and speculative schemes***).

*Meason v. Bank of Miami*, 652 F.2d 542, 549 (5th Cir. 1981). "***The federal securities statutes are remedial legislation and must be construed broadly, not technically and restrictively.***" *Paul F. Newton & Co. v. Texas Commerce Bank*, 630 F.2d 1111, 1118 (5th Cir. 1980).

Here, Barclays employed specified manipulative or deceptive acts and contrivances to help falsify Enron's finances and which were essential to the ongoing fraudulent scheme and course of business. In short, in order to pocket millions of dollars of fees, commissions, interest and other charges – profits from its investment in the fraudulent scheme and course of business – Barclays facilitated, furthered and participated in the fraud. All of these activities directly contravened

[15] To the extent *Ziemba v. Cascade Int'l, Inc.*, 256 F.3d 1194, 1205 (11th Cir. 2001), seems to require a statement be made about a company which is "publicly attributable to the defendant at the time the plaintiff's investment decision was made," it is inconsistent with *Zandford*.

prohibitions of 1934 Act. Barclays was not an unwitting victim of the fraud involving Enron – ***it was an active perpetrator of and participant in that fraud. Thus, Barclays's alleged liability is "primary"*** and not "***secondary***."

The CC asserts viable legal theories of recovery against Barclays under the 1934 Act and pleads ***in detail*** how Barclays ***intentionally or recklessly contributed to and furthered the fraud***, thus satisfying the "scienter" standard of the 95 Act as applicable to the 1934 Act. Barclays's scienter, *i.e.*, its "required state of mind" is well pleaded. The CC details specific fraudulent Enron transactions involving Barclays which were intentionally deceptive acts or contrivances to deceive – falsifying Enron's publicly reported financial results and financial condition and make Enron's business appear to be successful when it was not. *Infra* §V.

Thus, as to Barclays, the CC pleads 1934 Act ***"primary liability" based on legal theories*** of recovery rooted in the express language of §10(b) and Rule 10b-5 and pleads the facts in ***sufficient detail*** to satisfy the 95 Act's pleading standard.

And, in fact, many courts have upheld complaints against banks in §10(b)/Rule 10b-5 cases where, as here, manipulative or deceptive devices, contrivances and acts, and participation in a scheme to defraud have been alleged with sufficient particularity. *In re Livent, Inc. Noteholders Sec. Litig.*, 174 F. Supp. 2d 144, 150-52 (S.D.N.Y. 2001) (complaint alleging investment bank made disguised loan to Livent enabling Livent to falsify financial condition, while selling securities to public states valid §10(b)/Rule 10b-5 claims); *Murphy v. Hollywood Entm't Corp.*, No. 95-1926-MA, 1996 U.S. Dist. LEXIS 22207 (D. Or. May 9, 1996); *Flecker v. Hollywood Entm't Corp.*, No. 95-1926-MA, 1997 U.S. Dist. LEXIS 5329, at *25 (D. Or. Feb. 12, 1997) (refused to dismiss a complaint against investment bankers and then later refused to grant summary judgment to those banks, stating that their "***roles as analysts, investment bankers and business advisors with extensive contacts with [issuer] defendants, superior access to non-public information and participation in both drafting and decision-making is sufficient to establish a triable primary liability claim under §10(b)***"); *McNamara v. Bre-X-Minerals Ltd.*, No 5:97-CV-159, 2001 U.S. Dist. LEXIS 4571, at *166 (E.D. Tex. Mar. 30, 2001) (denied motion to dismiss by J.P. Morgan based on allegations it participated in a ***scheme*** to violate §10(b) and Rule 10b-5 by helping to structure fraudulent business transactions, acting as Bre-X's financial advisor, while ignoring "red flags" that Bre-X's assets were falsified). *See also SEC v. U.S. Envtl., Inc.,* 155 F. 3d 107, 112 (2d Cir. 1998) (while there is no aiding and abetting, where complaint properly alleged defendant to be primary violator because ***"'participated in the fraudulent scheme,'"*** noting ***"lawyers, accountants, and banks who engage in fraudulent or deceptive*** practices at their client's direction [are] a primary violator"); *Scholnick v. Continental Bank*, 752 F. Supp. 1317, 1323 & n.9 (E.D. Mich. 1990) ("bank ... may still be held liable under Rule 10b-5(a) and 10b-5(c) as a participant in the allegedly fraudulent scheme" and "allegations that Continental was directly involved in perpetuating a fraudulent scheme distinguish" case from situation where bank was only engaging in a "'routine commercial financing transaction'").

Of course, as with most fraudulent schemes, the scheme to falsify Enron's finances and inflate the prices of its securities – and sustain its fraudulent course of business – ultimately collapsed from the accumulated weight of years of deceit and deception. But the fact that the scheme ultimately collapsed in late 01 is of little legal moment. It had succeeded for years, enriching the perpetrators to the tune of billions of dollars. Securities violators frequently find themselves involved in complicated schemes by which financial reports are manipulated, securities prices are inflated, new securities are sold to the public and yet, despite all their efforts to perpetuate the wrongdoing, the scheme ultimately collapses and their participation is disclosed. But participants in fraudulent schemes – especially Ponzi securities schemes like Enron – expect them to succeed and take action to help them ***continue to succeed, as they gain more profits from the scheme as long as it continues***. The fact that such complex schemes may ultimately fail – and the perpetrators may ***then*** suffer some loss – in no way shields them from liability for the damage inflicted on the victims of their unlawful conduct while the scheme was succeeding. In the end, it is the public investors in a situation like Enron – the people and pension funds who invested ***billions of dollars to purchase newly-issued Enron securities or the publicly traded securities of Enron at inflated prices that are left holding the bag. They are the ones who are truly damaged***. And the federal securities laws are supposed to protect them.

The important remedial purposes of investor suits under the anti-fraud provisions of the 1934 Act were ***ratified by Congress when it enacted the 95 Act***:

> The overriding purpose of our Nation's securities laws is to protect investors and to maintain confidence in the securities markets, so that our national savings, capital formation and investment may grow for the benefit of all Americans.
>
> Private securities litigation is an indispensable tool with which defrauded investors can recover their losses without having to rely upon government action. Such private lawsuits promote public and global confidence in our capital markets and help to deter wrongdoing and to guarantee that ***corporate officers, auditors, directors, lawyers and others properly perform their jobs***.

141 Cong. Rec. H. 13691, at H13699 (daily ed. Nov. 28, 1995). Certainly the 95 Act's pleading requirements must be applied and interpreted with these important principles in mind.

It is an unfortunate reality that the worst securities frauds create the most difficult situations for the victims.[16] The issuer (here Enron) goes bankrupt – and is ***shielded from liability***. Whatever directors' and officers' liability insurance policies exist (here some $350 million) ***are impaired*** – as the carriers can claim that they were defrauded into issuing the policies by the issuer's false financial statements. Here, the situation is further exacerbated by the fact that defendant Andersen, which played a significant role in the fraud, is financially impecunious and able to pay only a fraction of the damages suffered by the victims.

If Enron investors are to achieve any significant recovery here, in what is acknowledged to be the largest and worst financial fraud in U.S. history, it will only be because our Nation's securities laws permit these victims to hold accountable ***securities professionals like banks and lawyers, who are supposed to safeguard the public in securities transactions, for their misconduct in employing acts and contrivances to deceive and participating in a scheme to defraud and a course of business that operated as a fraud or deceit on those purchasers of Enron's securities***. If our Nation's securities laws do not provide an opportunity for the thousands of investors in Enron – what appeared to be a hugely successful public company earning a billion dollars of profit a year – to pursue Enron's bankers and lawyers who allegedly engaged and participated in the fraudulent scheme and course of business that will make a mockery of the investor protection purposes of our securities laws. To put it bluntly, if the 95 Act's enhanced pleading standard combined with the Court's decision in *Central Bank* operate to shield the banks named as defendants here from even having to

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16 For instance, *Equity Funding*, *U.S. Financial*, *Lincoln Savings*, *Washington Public Power Supply Systems* and *Global Crossing*.

answer the CC and defend the allegations on the merits, then Congress will have to act by ameliorating that harsh pleading standard and restoring aiding and abetting liability.

## III. DETAILED ALLEGATIONS REGARDING INVOLVEMENT OF BARCLAYS

> In reviewing the sufficiency of a complaint in response to a motion to dismiss for failure to state a claim under Fed. R. Civ. P. 12(b)(6), before any evidence has been submitted, the district court's task is limited. *Scheuer v. Rhodes*, 416 U.S. 232, 236 (1974). The issue is not whether a plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support its claims. *Id.* The district court should consider all allegations in favor of the plaintiff and accept as true all well-pleaded facts in the complaint. *Lawal v. British Airways, PLC*, 812 F. Supp. 713, 716 (S.D. Tex. 1992). Dismissal is not appropriate "unless it appears beyond a doubt that the plaintiff can prove no set of facts in support of [his] claim which would entitle him to relief." *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957).

*Landry's*, slip op. at 4 n.8. The Fifth Circuit recently stated, "we will accept the facts alleged in the complaint as true and construe the allegations in the light most favorable to the plaintiffs." *Nathenson v. Zonagen Inc.*, 267 F.3d 400, 406 (5th Cir. 2001). The Court must consider the allegations in their entirety. As Judge Buchmeyer stated in *STI Classic Fund v. Bollinger Indus., Inc.*, No. 3-96-CV-823-R, 1996 U.S. Dist. LEXIS 21553, at *5 (N.D. Tex. Oct. 25, 1996), it is improper to isolate "the circumstances alleged in Plaintiffs' amended complaint rather than to consider them in their totality." *Id.* at *5.

Barclays argues that the three-year statute of response for 1934 Act claims bars plaintiffs from pursuing damages against them for any time period prior to 4/8/99 ***and*** any consideration of its alleged misconduct prior to 4/8/99 for pleading or other purposes. We agree as to the former point, but not as to the latter. In other words, while the three-year statute of repose bars damage recovery from Barclays on behalf of purchasers who purchased before 4/8/99, it does not affect plaintiffs' ability to plead conduct or present evidence of its misconduct prior to that date. *United States v. Ashdown*, 509 F.2d 793 (5th Cir. 1975), affirmed defendants' mail fraud convictions, holding there was no merit in the argument that it was error to admit evidence of acts committed beyond the statute of limitations period where the evidence helped to establish the scheme – "[t]he statute of limitations is a defense to prosecution, not a rule of evidence. Therefore, once prosecution is timely instituted, the statute of limitations has no bearing on the admissibility of evidence." *Id.*

at 798.[17] Instead, the court found that the evidence defendants questioned "***helps establish the scheme and the guilty intent***." *Id. Accord United States v. Blosser*, 440 F.2d 697, 699 (10th Cir. 1971) (evidence of mail fraud occurring before the statute of limitations "***bore on the existence of the scheme to defraud, the falsity of representations made, and intent***").[18]

A similar result was obtained in Title VII cases. *Fitzgerald v. Henderson*, 251 F.3d 345 (2d Cir. 2001), held that evidence of defendant's sexual advances and fact that the plaintiff rebuffed those advances at an earlier time were relevant to show defendant's motivation for the harassment that occurred during the time plaintiff's claim was ripe. "***A statute of limitations does not operate to bar the introduction of evidence that predates the commencement of the limitations period but that is relevant to events during the period***." *Id.* at 365.[19]

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17 There is no dispute that Barclays's claims were timely filed for the three-year period, beginning 4/8/99.

18 An early case upholding this principle is *Little v. United States*, 73 F.2d 861 (10th Cir. 1934). There, the court held that "if the mails were used in execution of a fraudulent scheme, it is no defense that the scheme was formed and partially carried out back of the statute of limitations. Proof running back of the statute is admissible provided it is connected up with the scheme existing when the letters were mailed." *Id.* at 867; *accord United States v. Marconi*, 899 F. Supp. 458, 463 (C.D. Cal. 1995) (defendant misunderstood the nature of the statute of limitations as "acts of fraud prior to that date are still evidence of this continuing fraudulent scheme to defraud ...." The trier of fact can consider defendant's pre-statute of limitations action to determine whether defendant had the requisite intent to defraud); *United States v. Whitt*, 718 F.2d 1494, 1501 (10th Cir. 1983) (certain testimony regarding events that were not within the statute of limitations was used "to establish a scheme or plan rather than as direct evidence"); *United States v. Haskins*, 737 F.2d 844, 848 (10th Cir. 1984) (Affirmed mail fraud and extortion convictions noting that arguments relating to evidence of transactions not charged in the indictment but used to help support scheme allegations could be properly admitted. "The fact that a number of the overt acts performed in furtherance of the conspiracy were committed beyond the statute of limitations does not preclude the admission in evidence of such acts to show the nature of the scheme and [the commissioner's] intent where the later use of the mails occurred."). Although these cases relate to evidentiary issues, the same reasoning should apply in this case at the motion to dismiss stage. If evidence can be admissible at trial regarding defendants' earlier acts in furtherance of their scheme then so too should allegations regarding actions taken beyond the statute of limitations be considered at the pleading stage.

19 In *Black Law Enforcement Officers Assoc. v. Akron*, 824 F.2d 475 (6th Cir. 1987), the Sixth Circuit found the lower court erred when it granted a motion by the City seeking to limit evidence presented in the case to events that occurred within the one year statute of limitations period. *Id.* at 479. "It is clear that the district court erred in using the statute of limitations to bar the admission of evidence. The function of a statute of limitations is to bar stale claims." *Id.* at 482-83. "'The statute of limitations is a defense ..., not a rule of evidence. Therefore, ... [it] has no bearing on the admissibility of evidence.'" *Id.* at 483. The Sixth Circuit found that plaintiffs were correct in offering evidence of events extending beyond the statute of limitations ***as "admissible to show motive, intent or continuing scheme***." *Id.* (citing *United States v. Garvin*, 565 F.2d 519, 523 (8th Cir. 1977)).

Barclays had an extensive relationship with Enron. Barclays provided ***both*** commercial banking and investment banking services to Enron, helped structure and finance one of Enron's key secretly-controlled partnerships/SPEs, *i.e.*, Chewco/JEDI and its billions of dollars of illicit transactions with Enron, thus enabling Enron falsify its financial statements and misrepresent its financial condition ***for over three years***. As a result of Barclays's participation in the scheme, it received huge fees and other payments from Enron and its controlled entities. ¶¶10, 22, 755, 758.[20]

Barclays's relationships with Enron were so extensive that ***top officials*** of the bank constantly interacted with top executives of Enron, *i.e.*, Lay, Skilling, Causey, McMahon or Fastow, on an almost daily basis throughout the Class Period, discussing Enron's business, finances and partnerships and their SPEs. Barclays was engaged and participated in key aspects of the fraudulent scheme and course of business in several ways.

Barclays was a major lender to Enron, participating in Enron's main credit facilities, loaning over $4 billion dollars to Enron or related entities, while helping to syndicate billions in bank loans or commitments to Enron or related entities. In addition to its funding of the critical Chewco/JEDI transaction in 12/97 (¶754):

- Barclays arranged and participated in a $500 million credit facility for JEDI in 5/98 to fund non-arm's-length fraudulent transactions with Enron.
- Barclays was the lead lender on a $2.3 billion debt facility to finance Enron's purchase of Wessex Water in 98 for which Enron overpaid so as to create a place to put defendant Rebecca Marks, who had lost out on a power struggle with Skilling over the CEO-ship of Enron.
- Barclays was a co-arranger of a $250 million loan to Enron in 11/97.

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[20] Barclays makes the point that the 500-page CC uses the word "help" or "helped" to describe its conduct vis-à-vis Enron on some occasions. Seizing on the word help/helped, Barclays claims that its use conclusively shows that the true core allegation against it here is one of aiding and abetting, which is barred by *Central Bank*. This argument is wrong. First of all, persons who participate in a scheme to defraud or a course of business that operates as a fraud or deceit on purchasers of a public company's securities or employ acts or manipulative or deceptive devices are actually "helping" to defraud investors. This is not medieval England where meritorious actions are dismissed because pleaders used an ambiguous word or mischaracterized a claim for relief. Fortunately, in the United States today, complaints are to be construed ***in favor of the pleader with all ambiguities resolved and inferences drawn in the pleader's favor***. And the CC clearly does repeatedly allege that Barclays participated in a fraudulent scheme or course of business while employing acts and manipulative or deceptive devices and/or contrivances. That conduct is actionable under the text of §10(b) and Rule 10b-5, as well as the wealth of decisions cited in this brief.

- Barclays participated in the 9/98 $1 billion commercial paper back-up credit facility for Enron.
- Barclays participated in the 8/01 $3 billion commercial paper back-up credit facility for Enron.
- Barclays participated in a $250 million revolving credit facility for Enron arranged in 11/98.

Barclays's multi-billion dollar commercial paper back-up credit facilities for Enron were ***extremely significant***. They enabled Enron to stay liquid by helping Enron maintain its access to the commercial paper market where it could borrow billions to finance day-to-day operations, while Barclays pocketed huge commitment fees on the back-up credit line. ¶755. Barclays also helped raise some $1.9 billion for Enron through the sale of Enron's zero coupon convertible notes in 2/01 which funds were used to repay Enron's short term debt – which benefitted Barclays, a major Enron banker.

Barclays was willing to engage and participate in the fraudulent scheme and course of business because its participation created large profits for Barclays – ***as long as the Enron scheme continued in operation*** – something that Barclays was in a unique position to cause. While Barclays was lending billions to Enron, it was limiting its own risk in this regard, as it knew that so long as Enron maintained its investment grade credit rating and continued to report strong current period financial results and credibly forecast strong ongoing revenue and profit growth, ***Enron's access to the capital markets would continue to enable Enron to raise hundreds of millions, if not billions, of dollars of fresh capital from public investors which would be used to repay or reduce Enron's commercial paper debt and the loans from Barclays to Enron so that the scheme could continue***. ¶755.

In fact, the proceeds of Enron's securities offerings during the Class Period underwritten by Barclays or other investment banks – ***including the proceeds of the $1.9 billion 0% convertible note offering in 2/01*** – were utilized to repay Enron's existing commercial paper and bank indebtedness, including indebtedness to Barclays. Thus, throughout the Class Period, Barclays was pocketing millions of dollars a year in interest payments, syndication fees and investment banking fees by participating in the Enron scheme to defraud and stood to ***continue*** to collect these huge amounts on an annual basis going forward so long as it helped perpetuate the Enron Ponzi scheme. ¶755.

Barclays also participated in and furthered the fraudulent scheme by participating in key illicit transactions with Enron which it knew would contribute materially to Enron's ability to continue to falsify its financial condition and thus continue the operation of the Enron Ponzi scheme, *i.e.*, the Chewco/JEDI entity which Enron secretly controlled. ¶756. At year-end 97, Enron encountered a crisis when the investor in the JEDI partnership, which Enron had been using to do transactions with to generate substantial amounts of profits during 97, as well as move debt off its balance sheet, insisted Enron buy out its interest in the JEDI partnership. Because Enron could not find a legitimate independent third-party investor to buy out the other investor's interest in JEDI, Enron faced a crisis which, unless solved, would result in Enron being forced to ***wipe out 40% of the profits it had earlier reported during 97 and put millions of dollars of debt back on its balance sheet, with very adverse consequences for Enron's stock price***. ¶757.

So, Barclays and Enron quickly put Chewco together to buy out the other investor's interest in JEDI. However, as Enron and Barclays both knew, to be legitimate, this required that Chewco be ***independent*** of Enron ***and*** have ***independent equity investors which held at least 3% of Chewco***. No such investor could be found so Barclays agreed to loan $240 million to Chewco ***on unusually favorable terms to Barclays, receiving not only extra high interest rate payments but very significant commitment and lending fees, and also a secret guarantee of report of the loan by Enron***! ***In addition, Barclays agreed to make available approximately $11.4 million in what were called "equity loans"*** to the purported equity investors in Chewco. However, because Barclays knew those equity investors were straw persons, who did not have independent credit standing or assets sufficient to justify loans of this size, Barclays required that Chewco/Enron provide a ***secret $6.6 million cash deposit with Barclays to offset the so-called "equity loans" to those straw parties. Thus, Barclays knew Chewco was not independent of Enron and that the structure of the Chewco/JEDI partnership was a sham. Chewco was controlled by Enron and had little or no outside equity in it. Barclays and Enron had formed Chewco not only for the purpose of preventing a disastrous unwinding or restatement of Enron's previously reported 97 profits, but***

***also to create a secretly controlled entity that Enron and Barclays could use going forward to do other non-arm's-length transactions with to generate huge artificial profits for Enron and to move billions of dollars of debt off Enron's balance sheet – and lots of fees and interest payments to Barclays***. ¶758.

Barclays's surreptitious funding of Chewco with its secret guarantees and cash deposits to protect itself against loss was an essential, indeed indispensable, part of Enron's scheme of concealing its true debt levels by moving billions of dollars of debt off its books and onto the books of SPEs it secretly controlled, while improperly recognizing millions of dollars of profits on transactions with those entities not only at year end 97 ***but for the next three years***! During 98, Barclays funded Chewco/JEDI with another $500 million to allow Chewco/JEDI to complete more and more transactions to artificially inflate Enron's reported results and deceive investors. ***The importance of the Chewco/JEDI transactions can not be overstated. Later on, when the Enron scheme collapsed and Enron was forced to restate its prior financial results, the impact of its illicit transactions with Chewco were enormous***. ¶759.

***On 10/16/01, Enron shocked the markets with revelations of $1.0 billion in charges and a reduction of shareholders' equity by $1.2 billion***. Within days, *The Wall Street Journal* began an exposé of Chewco. In 11/01, Enron was ***forced to admit that Chewco had never satisfied the SPE accounting rules and – because JEDI's non-consolidation depended on Chewco's status – neither did JEDI, and Enron consolidated Chewco and JEDI retroactive to 97. Enron also admitted it had failed to correct $51 million in errors found by Andersen for 97. This retroactive consolidation resulted in a massive reduction in Enron's reported net income and massive increase in its reported debt***. Enron restated its 97, 98, 99 and 00 financial results to eliminate $600 million in previously reported profits and approximately $1.2 billion in shareholders' equity as detailed below (¶61):

| ENRON ACCOUNTING RESTATEMENTS | | | | |
|---|---|---|---|---|
| | 1997 | 1998 | 1999 | 2000 |
| **Recurring Net Income** Amount of Overstatement | $ 96,000,000 | $113,000,000 | $250,000,000 | $ 132,000,000 |
| **Debt** Amount of Understatement | $711,000,000 | $561,000,000 | $685,000,000 | $ 628,000,000 |
| **Shareholders' Equity** Amount of Overstatement | $313,000,000 | $448,000,000 | $833,000,000 | $1,208,000,000 |

Without Barclays's active participation, Chewco/JEDI would not and could not have occurred. Without Chewco/JEDI, the Enron fraudulent scheme would not have taken place. The Chewco partnership ***was used by Enron management to enter into billions of dollars of transactions that Enron could not, or would not, do with unrelated commercial entities*** – and that ***generated favorable financial results for Enron but did not achieve bona fide economic objectives or to transfer risk.*** These contrived, non-arm's-length and fraudulent transactions allowed Enron to conceal from the market ***very large losses resulting from Enron's merchant investments.*** ¶62.[21]

While Barclays now claims it was the accounting for these bogus transactions that ***misled*** and harmed investors – it overlooks that these transactions could not have occurred or been misaccounted for without its active participation in these contrivances and deceptive devices – in structuring and funding the huge JEDI/Chewco phony deal at year-end 97 and many more contrived transactions which were really devices to deceive during 98-00 while demanding secret guarantees of repayment and secret offsetting cash deposits to protect itself.

[21] As huge as the 11/01 restatements of Enron's 97-00 financial statements were, they just scratched the surface of the true extent of the prior falsification of Enron's financial statements, failing to eliminate additional hundreds of millions of dollars of phony profits. ¶63.

## IV. BARCLAYS CAN BE LIABLE UNDER 1934 ACT §10(b) AND RULE 10b-5 (i) FOR MAKING FALSE STATEMENTS, OR (ii) FOR PARTICIPATING IN A FRAUDULENT SCHEME OR COURSE OF BUSINESS THAT OPERATED AS A FRAUD OR DECEIT ON PURCHASERS OF ENRON'S SECURITIES, OR (iii) FOR EMPLOYING ACTS OR MANIPULATIVE DEVICES TO DECEIVE

Plaintiffs here have pleaded and are pursuing theories of recovery against Barclays that are well-grounded in the express language of §10(b) of the 1934 Act which states:

> Manipulative and deceptive devices
>
> It shall be unlawful for any person, directly or indirectly ....
>
> * * *
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange ... ***any manipulative or deceptive device or contrivance*** in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.[22]

Rule 10b-5 promulgated by the SEC flows directly from the language of §10(b) itself and provides:

> §240.10b-5. Employment of manipulative and deceptive devices.
>
> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

Not only does Rule 10b-5 forbid the making of "any untrue statement of a material fact," it also provides for scheme liability. Scheme liability is authorized by the text of §10(b). According to the Supreme Court, §10(b)'s prohibition of "any ***manipulative or deceptive device or contrivance***"

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22 Note that §10(b) itself does not expressly prohibit untrue statements of material facts or material omissions. This prohibition, like the prohibition against fraudulent schemes and fraudulent courses of business, are in Rule 10b-5.

necessarily encompasses any "***scheme to defraud***." In *Hochfelder*, 425 U.S. 185, the Court referred to the dictionary definitions of §10(b)'s words, to find that a "device" is "'[t]hat which is devised, or formed by design; a contrivance; an invention; project; ***scheme; often, a scheme to deceive***; a stratagem; an artifice.'" *Id.* at 199 n.20 (quoting *Webster's International Dictionary* (2d ed. 1934)). The Court found that a "contrivance" means "'***a scheme, plan, or artifice***.'" *Id.* (quoting *Webster's International Dictionary* (2d ed. 1934)); *see also Aaron*, 446 U.S. at 696 n.13. Clearly, "scheme" is encompassed in the broad language of §10(b).

Thus, Rule 10b-5 – adopted by the SEC to implement §10(b) – makes it unlawful for any person "***directly or indirectly***" to employ "***any*** device, ***scheme***, or artifice ***to defraud***," "***[t]o make any untrue statement[s]***," or to "***engage in any act, practice, or course of business which operates ... as a fraud or deceit upon any person***." 17 C.F.R. §240.10b-5. *See also U.S. Quest,* 228 F.3d at 407.

For instance, in *Finkel*, 817 F.2d 356, plaintiffs sued under §10(b) and Rule 10b-5, claiming that the stock of Docutel was inflated due to false financial reports. According to plaintiff, Olivetti (which owned 46% of Docutel and controlled it) forced Docutel to buy Olivetti's excess inventories at inflated prices so Olivetti could hide losses it was suffering. Docutel concealed this financial manipulation for some time but, when its auditors discovered the financial manipulation and forced a large inventory writedown, huge losses were disclosed and Docutel stock fell. The district court dismissed the complaint against Olivetti and Docutel because plaintiff failed to allege reliance on any of the false statements in Docutel's SEC filings that were alleged in the complaint.

> But the fact that the complaint lists a number of documents filed with the SEC does not limit plaintiff's claim to subsection (2) only. For, as in *Shores*, plaintiff's lack of reliance on these documents does not resolve the claims made under 10b-5(1) and (3). ***We find that plaintiff's complaint properly alleges a scheme to defraud or course of business operating as a fraud for purposes of the first and third subsections; plaintiff's complaint, taken as a whole, alleges that Olivetti forced Docutel to take its worthless inventories, that this scheme or course of business was not disclosed, and that the effect was to defraud certain purchasers of Docutel....***
>
> The most significant event which allegedly led to the loss by plaintiff is the claim that Olivetti forced Docutel to take worthless inventories without disclosing that fact in the market place; ***if proved, that conduct could equate with a scheme to defraud or course of business operating as a fraud in violation of 10b-5(1) and (3)***. Thus, we

> conclude that the district court erred in its dismissal of the complaint as to plaintiff's claims under 10b-5(1) and (3).

*Id.* at 363-64. *Accord Heller v. Am. Indus. Props. Reit*, Civ. No. SA-97-CA-1315-EP, 1998 U.S. Dist. LEXIS 23286, at *14 (W.D. Tex. Sept. 25, 1998) ("The first and third subsections, on the other hand, ***create a duty not to engage in a fraudulent scheme or course of conduct*** ....").

Thus, the Fifth Circuit sitting *en banc* held that a defendant who did not himself make the statements in a misleading offering circular could be held primarily liable ***as a participant in a larger scheme to defraud of which that offering circular was only a part: "Rather than containing the entire fraud, the Offering Circular was assertedly only one step in the course of an elaborate scheme.*** " *Shores*, 647 F.2d at 468.

The fraudulent scheme and course of business involving Enron ***was worldwide in scope, years in duration and unprecedented in scale*** and required the skills and active participation of lawyers, bankers and accountants to help design, implement, conceal and falsely account for the deceptive acts and devices, manipulative or deceptive contrivances and artifices they and Enron were using to falsify Enron's reported profits and financial condition and to continue its fraudulent course of business.

The notion that *Central Bank*, issued a broad edict that lawyers, bankers and accountants are immune from liability for their participation in complex securities frauds is nonsense. *Central Bank* expressly recognized: "The absence of §10(b) aiding and abetting liability ***does not mean that secondary actors in the securities markets are always free from liability under the securities Acts. Any person or entity, including a lawyer ... or bank, who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser ... relies may be liable as a primary violator under 10b-5 .... In any complex securities fraud, moreover, there are likely to be multiple violators*** ...." 511 U.S. at 191. A scheme to defraud often will involve a variety of actors, and investors are entitled to allege "***that a group of defendants acted together to violate the securities laws, as long as each defendant committed a manipulative or deceptive act in furtherance of the scheme.*** " *Cooper*, 137 F.3d at 624; *accord First Jersey*, 101 F.3d at 1471; *In re Health Mgmt. Inc. Sec. Litig.*, 970 F. Supp. 192, 209 (E.D.N.Y. 1997); *Adam v. Silicon Valley Bancshares*, 884 F. Supp.

1398, 1401 (N.D. Cal. 1995); *In re ZZZZ Best Sec. Litig.*, 864 F. Supp. 960, 699-70 (C.D. Cal. 1994).

In *Central Bank*, a public building authority issued bonds to finance public improvements. Central Bank served as indenture trustee. The bonds were secured by liens covering property. The bond covenants required that the liened land be worth at least 160% of the principal amount of the bonds. Central Bank got a letter expressing fear that property values were declining and that perhaps the 160% value test was no longer met. The bank did nothing. Central Bank, which had no commercial lending relationship with the municipal entity involved and which was not an investment bank, issued no analysts' reports about the issuer of the municipal bonds and thus made no statement and took no affirmative act that could have affected the trading price of the municipal bonds in issue. Soon afterwards, the public building authority defaulted on the bonds. The bonds were not publicly traded. Clearly, this is a significantly different fact pattern from the *Enron* situation.

The *Central Bank* majority noted that their reasoning was "confirmed" by the fact that if they accepted the plaintiffs' aiding and abetting argument it would impose §10(b) liability "when at least one element critical for recovery" was absent, *i.e.*, reliance (511 U.S. at 180) (citing *Basic*, the Supreme Court's "***fraud-on-the-market***" decision) for the proposition that a plaintiff must show reliance to recover under 10b-5. "Were we to allow the aiding and abetting action proposed in this case, the defendant could be liable without any showing that the plaintiff relied upon the aider and abettor's statements ***or actions***." *Central Bank*, 511 U.S. at 180. The Court found that allowing plaintiffs to "circumvent the reliance requirement would disregard the careful limits on 10b-5 recovery as mandated by our earlier cases." *Id.* However, in this case, the alleged scheme and fraudulent course of business ***inflated*** the prices of Enron's ***publicly traded*** securities. ¶¶74, 418-424, 750-761. Thus, the reliance element is not "***absent***" and the Supreme Court's prior decision in *Basic* is not circumvented – it is satisfied.

*Central Bank* denied recovery to victims of an alleged securities fraud who pleaded only one theory of recovery against the defendant bank – secondary liability dubbed "aiding and abetting." 511 U.S. at 191. However, the words aiding and abetting do not appear in §10(b) or Rule 10b-5. The Court said "***[T]he text of the 1934 Act does not itself reach those who aid and abet a § 10(b)***

***violation ... that conclusion resolves the case.*** *Id.* at 177. The *Central Bank* plaintiffs did not, as the plaintiffs do here, plead or pursue recovery under the theory that the bank defendant made false and misleading statements in Registration Statements or other documents issued to the public, *e.g.*, analysts' reports ***or*** employed acts and manipulative or deceptive devices, or engaged in a fraudulent scheme or course of business that operated as a fraud or deceit on purchasers of the securities in issue. In the words of the Court, the plaintiffs "concede that Central Bank did not commit a manipulative or deceptive ***act*** within the meaning of §10(b)." *Id.* at 191. Thus, because the *Central Bank* plaintiffs pursued a theory of recovery which found ***no support in the text of either the statute or the rule, they lost.***

*Central Bank* cannot mean that a defendant cannot be liable under §10(b) unless it made misleading statements because the Court rejected that argument in *O'Hagan,* 521 U.S. 642. The Eighth Circuit had held that, under *Central Bank,* "§10(b) covers only deceptive statements or omissions on which purchasers and sellers, and perhaps other market participants, rely." *Id.* at 664. The Court reversed, holding that §10(b) does not require a defendant to speak. *Id.* Because §10(b) prohibits "'any manipulative or deceptive device or contrivance'" in contravention of SEC rules, this reaches "any deceptive device," whether or not the defendant spoke. *O'Hagan*, 521 U.S. at 650-51. *Superintendent of Ins.* is consistent with *O'Hagan*. In *Superintendent of Ins.*, a ***unanimous*** Court upheld a §10b/Rule10b-5 complaint involving a "fraudulent scheme" involving the sale of securities where ***no*** false statement was alleged because:

> ***There certainly was an "act" or "practice" within the meaning of Rule 10b-5 which operated as "a fraud or deceit" on Manhattan, the seller of the Government bonds.***

404 U.S. at 9.

This Court has stated, citing *O'Hagan*, that: "***A defendant need not have made a false ormisleading statement to be liable.***" *Landry's*, slip. op. at 9 n.12; *Waste Mgmt.*, slip op. at 75; *BMC Software*, 183 F. Supp. 2d at 869. Thus, the fact that the CC does not allege that Barclays itself made false statements is not fatal to the §10(b)/Rule 10b-5 claim asserted against it.

That this reading of §10(b)/Rule 10b-5 is clearly correct is shown by a new ***unanimous*** Supreme Court decision – *Zandford*, 2002 U.S. LEXIS 4023. In *Zandford*, the Court repeatedly cited with approval its seminal *"fraudulent scheme"* case *Superintendent of Ins.*, and reversed dismissal of a §10(b)/Rule 10b-5 complaint making the following key points:

- ***"The scope of Rule 10b-5 is coextensive with the coverage of §10(b)*** ...." *Id.* at *7 n.1.
- ***"[N]either the SEC nor this Court has ever held that there must be a misrepresentation about the value of a particular security" to violate §10(b).*** *Id.* at *13.[23]
- Allegations that defendant "'***engaged in a fraudulent scheme***'" or "'***course of business that operated as a fraud or deceit***'" stated a §10(b) claim. *Id.* at *13, *14-*17.

*Central Bank* clearly – ***but merely*** – stands for the proposition that no aiding and abetting liability exists under the 1934 Act because neither §10(b) nor Rule 10b-5 contain "aiding and abetting" language. The decision in *Central Bank* is ***quite narrow***. By contrast, the language of §10(b) and Rule 10b-5 is ***very broad***. Also, the purposes of §10(b) and Rule 10b-5 are remedial, intended to provide access to federal court to persons victimized in securities transactions:

> [T]he 1934 Act and its companion legislative enactments [including the 1933 Act] embrace a "fundamental purpose ... to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry...." Congress intended securities legislation enacted for the purpose of avoiding frauds to be construed "not technically and restrictively, but flexibly to effectuate its remedial purposes."

*Affiliated Ute Citizens*, 406 U.S. at 151. As noted by the Fifth Circuit:

> [T]he Court has concluded that the Exchange Act and the Securities Act should be construed broadly to effectuate the statutory policy affording extensive protection to the investing public. *See Tcherepnin*, 389 U.S. at 336.... *See also* S.Rep.No. 47, 73d Cong. 1st Sess. 1 (1933) (indicating legislative intent of the Securities Act to protect the public from the sale of fraudulent ***and speculative schemes***).

*Meason*, 652 F.2d at 549. "The federal securities statutes are remedial legislation and must be construed broadly, not technically and restrictively." *Paul F. Newton*, 630 F.2d at 1118.[24]

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[23] To the extent *Ziemba*, 256 F.3d at 1205, seems to require a statement be made about a company which is "publicly attributable to the defendant at the time the plaintiff's investment decision was made," it is inconsistent with *Zandford.*

[24] The broad purposes of §10(b)'s prohibition of securities fraud and the Supreme Court's longstanding recognition of such broad purposes also support conspiracy and scheme liability. *See, e.g., Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 477 (1977) ("[n]o doubt Congress meant to prohibit the full range of ingenious devices that might be used to manipulate securities prices"); *Affiliated Ute Citizens*, 406 U.S. at 151 (proscriptions of §10(b) and Rule 10b-5 "are broad and, by repeated use of the word 'any,' are obviously meant to be inclusive. The Court has said that the 1934 Act and its companion legislative enactments embrace a 'fundamental purpose ... to substitute a

The view that *Central Bank* eliminated scheme liability is flawed. Notwithstanding *Central Bank*, primary liability may be based on participation in a scheme to defraud or a course of business that operated as a fraud or deceit on securities purchasers pursuant to subsections (a) or (c) of Rule 10b-5 continue to be viable theories of liability.

Fraudulent scheme or course of business liability is viable because:

- It is encompassed by the express language of the statute, which prohibits the "direct[] or indirect[] ... use or employ[ment]" of "any manipulative or deceptive device or contrivance";
- It is encompassed by the express language of Rule 10b-5;
- It comports with the broad antifraud purposes of the statute;
- It has long been upheld by the courts; and
- It imposes liability based on a primary violation of the federal securities laws committed directly by the defendant that goes beyond merely assisting another in committing a violation.

In *Central Bank*, the plaintiffs did not allege primary liability against the bank, did not allege a conspiracy, did not allege a scheme to defraud, did not allege a fraudulent practice or course of business, and did not invoke subsections (a) or (c) of Rule 10b-5.[25] The plaintiffs alleged only that the bank was "'***secondarily*** liable under § 10(b) for its conduct in ***aiding and abetting the fraud***.'" 511 U.S. at 168. The Court, therefore, did not address those other liability theories. *See Adam*, 884 F. Supp. at 1400 (noting that *Central Bank* did not address conspiracy liability); *but see Wenneman v. Brown*, 49 F. Supp. 2d 1283, 1288 (D. Utah 1999) ("In this Court's opinion, the holding in *Central Bank* [precluding aiding and abetting liability] applies with equal force to subsections (a), (b), and

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philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry.'") (quoting *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963)); *Capital Gains Research,* 375 U.S. at 186 (§10(b) should be construed "not technically and restrictively, but flexibly to effectuate its remedial purposes"); *Superintendent of Ins.*, 404 U.S. at 11 n.7 ("'[We do not] think it sound to dismiss a complaint merely because the alleged scheme does not involve the type of fraud that is "usually associated with the sale or purchase of securities." We believe that §10 (b) and Rule 10b-5 prohibit ***all*** fraudulent schemes in connection with the purchase or sale of securities, whether the artifices employed involve a garden type variety of fraud, or present a unique form of deception. Novel or atypical methods should not provide immunity from the securities laws.'") (quoting *A. T. Brod,* 375 F.2d at 397).

[25] The *Central Bank* decision did not distinguish among the different subsections of Rule 10b-5.

(c) of Rule 10b-5."). Yet defendants offer up numerous rationales as to why *Central Bank* eliminated Rule 10b-5(a) and (c) liability. They are:

1. ***The "Textualist" Rationale.*** The Court took a strict textualist approach in concluding that there is no private aiding and abetting liability under §10(b). Just as the statute does not explicitly mention "aiding and abetting," it also does not mention "scheme," "act," "practice," or "course of business."

2 ***The "Manipulation and Misrepresentation Is It" Rationale.*** The Court stated that "the statute prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act," *Central Bank*, 511 U.S. at 177, which must be interpreted to mean that liability can only be premised upon conduct falling within subsection (b) of Rule 10b-5.

3. ***The "No More Secondary Liability" Rationale.*** The Court's opinion holds that only primary violators may be held liable. Because scheme liability is a secondary liability theory similar to aiding and abetting, it is precluded.

None of these rationales for precluding fraudulent scheme and/or course of business liability under Rule 10b-5(a) and (c) is supportable because scheme and course of business liability is a ***textually-based, primary liability theory*** and there is no hard and fast rule that a defendant must make a false statement to face §10(b) liability.

- ***The Flaws of the "Textualist" Rationale***

A major flaw of the textualist rationale is that scheme liability is ***firmly based*** on the language of both the statute and the rule. The statute itself contains only the general "***manipulative or deceptive devices or contrivances***" language, leaving it to the SEC to more specifically proscribe fraudulent conduct. The SEC's rule-making authority would be superfluous if the rules it adopted had to use precisely the same words as in the statute. To be sure, "the private plaintiff may not bring a 10b-5 suit against a defendant for acts not prohibited by the text of § 10(b)," 511 U.S. at 173, and "'the 1934 Act cannot be read more broadly than its language and the statutory scheme reasonably permit,'" *id.* at 174 (quoting *Chiarella v. United States*, 445 U.S. 222, 234 (1980)). But it is patently reasonable for the SEC to have determined that the "employment" of a "scheme to defraud" and the "engagement" in a fraudulent "act, practice, or course of business" constitute the "use or employ[ment]" of a "manipulative or deceptive device or contrivance."[26]

In *Hochfelder*, 425 U.S. 185, the Court implicitly found that a "scheme to defraud" falls within the meaning of the "manipulative or deceptive device or contrivance" language of §10(b). *Id.* at 199 n.20. The Court relied in part on the 1934 dictionary definitions of "device" and "contrivance." *See id.*; *see also Aaron*, 446 U.S. at 696 n.13 (relying on same definitions to find scienter requirement under §17(a)(1) of 1933 Act). Both of those definitions included a "scheme." *See Hochfelder*, 425 U.S. at 199 n.20.[27]

The Court itself showed that *Central Bank* should not be interpreted as ushering in a new era of strict textualist construction of the federal securities laws. In upholding the misappropriation theory of insider trading in *O'Hagan*, 521 U.S. 642, the Court upheld a non-textual form of securities fraud and, in doing so, again exposed the long familiar broad expressions of the remedial purposes of the statute.[28]

- ***The Flaws of the "Manipulation and Misrepresentation Is It" Rationale***

The Court in *Central Bank* said that §10(b) "prohibits only the making of a material misstatement (or omission) ***or the commission of a manipulative act.***" 511 U.S. at 177. It also

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26 No subsection of Rule 10b-5 has ever been successfully challenged in any court as being outside the scope of §10(b) in the 60-year existence of the Rule.

27 The statutory prohibition against "directly or indirectly" violating §10(b) must cover a scheme to commit manipulative or deceptive acts. It is unlikely that Congress would have prohibited the direct commitment of a fraudulent act and yet approved the commission of the same fraudulent act through joint activity – *i.e.*, a scheme. The "directly or indirectly" language in §10(b) was not enough for the Supreme Court to save aiding and abetting liability in *Central Bank*. But that was because aiding and abetting liability covered a broader range of conduct than the direct commission of a manipulative or deceptive act. Scheme conduct, however, involves joint action to commit a manipulative or deceptive act that should itself be considered, directly or indirectly, a manipulative or deceptive act by each of the schemers.

28 The Court also noted that the misappropriation theory is designed to protect the integrity of the securities markets against abuses and that the 1934 Act was enacted in part to insure the maintenance of fair and honest markets and thereby promote investor confidence. 511 U.S. at 652, 657, 658-59. For example, the Court stated that "[t]he theory is also well-tuned to an animating purpose of the Exchange Act: to insure honest securities markets and thereby promote investor confidence." *Id.* at 658. The Court detailed how investors would be hesitant to invest in an unfair market. *See id.*

indicated §10(b) liability existed where there was reliance or a defendant's "statements or actions." *Id.* at 180; *see also id.* at 191 ("Any person or entity, including a lawyer, accountant, or bank, who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under 10b-5, assuming ***all*** of the requirements for primary liability under Rule 10b-5 are met.").

There is absolutely nothing in the language of the statute, the legislative history, or the rule that warrants restricting liability solely to misrepresentations or omissions or certain technical forms of manipulation. The express language of §10(b) clearly allows for liability by a person who does not actually make a statement or omit to say something he is under a duty to disclose. The statutory language "directly or indirectly ... [t]o use or employ" in §10(b) is much broader than simply "directly to make." Similarly, the statutory language "any manipulative or deceptive device or contrivance" is much broader than simply "a misrepresentation or omission." Therefore, if the starting point in interpreting a statute is the language itself, *see Central Bank*, 511 U.S. at 173, there is no reason why liability under §10(b) must be limited to directly making misstatements or omissions or manipulating securities prices through certain specific technical or mechanical means.[29]

In addition, the SEC, in adopting subsections (a) and (c) of Rule 10b-5, implicitly recognized this. ***Unless this Court would strike down a rule that has been upheld for 60 years, the language "employ any device, scheme, or artifice to defraud" and "engage in any act, practice, or course of business which operates or would operate as a fraud or deceit" in subsections (a) and (c) of Rule 10b-5 is much broader than simply "make a misrepresentation or omission."***[30]

If the Court in *Central Bank* meant to strike down subsections (a) and (c) of Rule 10b-5, the Court certainly would have explicitly said so. To the contrary, the courts have long recognized that the scope of liability under subsections (a) and (c) of Rule 10b-5 is broader than that under subsection (b) and that those who engage in a fraudulent scheme may be liable in the absence of

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[29] As the Supreme Court has stated, "***[n]o doubt Congress meant to prohibit the full range of ingenious devices that might be used to manipulate securities prices.***" *Santa Fe*, 430 U.S. at 477.

[30] Even from a common sense standpoint, schemes, acts, practices, and courses of conduct can readily be manipulative or deceptive, irrespective of any statements or omissions.

misrepresentations or omissions. *See, e.g., Affiliated Ute Citizens*, 406 U.S. at 152-53 (subsections (a) and (c) are broader than subsection (b) of Rule 10b-5); *First Jersey*, 101 F.3d at 1471-72; *SEC v. Seaboard Corp.*, 677 F.2d 1301, 1312 (9th Cir. 1982); *Shores*, 647 F.2d at 468; *Competitive Assocs.*, 516 F.2d at 814-15 ("Not every violation of the anti-fraud provisions of the federal securities law can be, or should be, forced into a category headed 'misrepresentations' or 'nondisclosures.' ***Fraudulent devices, practices, schemes, artifices and courses of business are also interdicted by the securities laws.***"); *Blackie v. Barrack*, 524 F.2d 891, 904 n.19 (9th Cir. 1975) ("Rule 10b-5 liability is not restricted solely to isolated misrepresentations or omissions; ***it may also be predicated on a 'practice, or course of business which operates ... as a fraud***...."'); *Richardson v. MacArthur*, 451 F.2d 35, 40 (10th Cir. 1971) ("Rule 10b-5 is a remedial measure of far greater breadth than merely prohibiting misrepresentations and nondisclosures concerning stock prices. No attempt is made in 10b-5 to specify what forms of deception are prohibited; rather, ***all fraudulent schemes in connection with the purchase and sale of securities are prohibited***.") (emphasis in original and added).

- ***The Flaws of the "No More Secondary Liability" Rationale***

The principal flaws of this rationale are that *Central Bank* did not strike down every form of "secondary" liability and that, in any event, violations through fraudulent schemes, acts, practices, or courses of business constitute primary violations of §10(b). In *Central Bank*, the Court did not make fine distinctions between conduct that constitutes a "primary" as opposed to that which constitutes a "secondary" violation of the statute. Nor did it hold that only "primary" violations are cognizable. It held that aiding and abetting could not constitute a violation because, as interpreted by the courts, aiders and abettors did not commit violations ***but only assisted them***, and the statute holds liable only those who commit violations.

Fraudulent acts, practices and scheme liability and course of business are ***primary*** liability theories in the sense that the defendant is directly liable for committing a violation of the statute. ***The fraudulent scheme, act, practice, or course of business is a direct violation of §10(b) and Rule 10b-5.*** With respect to fraudulent acts, practices and a participation in the scheme to defraud or fraudulent course of business is itself the manipulative or deceptive act, even without the making of misrepresentations or omission. There is nothing derivative, vicarious, or secondary about it. ***And Barclays here allegedly made false and misleading statements as well.***

All three subsections of Rule 10b-5 proscribe conduct for which a defendant may be ***primarily*** liable. Therefore, liability for a scheme to defraud or fraudulent act, practice, or course of business does not run afoul of *Central Bank*'s elimination of aiding and abetting liability. Cases both before and after *Central Bank* have recognized that scheme liability is a form of primary liability. *Hill v. Hanover Energy, Inc.*, Civ. No. 91-1964 (JHG), 1991 U.S. Dist. LEXIS 18566 (D.D.C. Dec. 16, 1991), is an example of such a pre-*Central Bank* case. In *Hill*, the defendant argued that the §10(b) claim should be dismissed for failure of the plaintiffs to allege any misrepresentations or omissions of material facts. *Id.* at *10-*11. The court rejected that argument, specifically finding that *Santa Fe* does not restrict §10(b) liability to misrepresentations or omissions. *See id.* at *11-*12. Rather, the court found that the alleged conduct of the defendant Hanover Energy, which included fraudulently inducing the plaintiff to give up his rights to acquire certain stock and to post a letter of credit, could fairly be viewed as manipulative or deceptive within the meaning of §10(b) and an unlawful scheme to defraud within the meaning of subsection (a) or (c) of Rule 10b-5. *See id.*[31]

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[31] District court decisions after *Central Bank* have continued to recognize scheme liability as a form of primary liability. For example, in *BMC Software*, 183 F. Supp. 2d at 885-86, this Court seemed to recognize scheme liability, although it found that the plaintiffs had failed to satisfy the pleading requirements. In *BMC*, when discussing the pleading requirements in securities fraud cases and what must be pled to support scheme allegations, this Court stated:

> As its first ground for dismissal, Defendants emphasize that the amended complaint fails to allege with any particularity that nine of the eleven individual Defendants made any representations or participated in any way in the alleged scheme to defraud.... ***Plaintiffs must allege what actions each Defendant took in furtherance of the alleged scheme and specifically pled what he learned, when he learned it, and how Plaintiffs know what he learned....***
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> * * *
>
> ***"Primary liability may be imposed 'not only on persons who made fraudulent misrepresentations but also on those who had knowledge of the fraud and assisted in its perpetration.'"***

*Id.* at 885-86, 905-06.

A scheme is "'[a] plan or program of something to be done.'"[32] *Aaron*, 446 U.S. 696 n.13. A "scheme to defraud" encompasses any "plan designed or concocted for perpetrating a fraud." *Ballentine's Law Dictionary* ("scheme to defraud") 1142 (3d ed. 1969). It has long included any scheme to defraud investors by causing securities to trade at fraudulently inflated prices.[33] When

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District court decisions prior to *Central Bank* held that scheme liability existed. In *ZZZZ Best*, 864 F. Supp. 960, the district court directly addressed Ernst & Young's liability under subsections (a) and (c) of Rule 10b-5, explicitly recognizing that liability under §10(b) and Rule 10b-5 is not restricted to material misstatements and omissions. *Id.* at 971-72 ("It appears that the scope of deceptive devices or schemes prohibited by subsections (a) and (c) [of Rule 10b-5] is quite extensive."). The plaintiffs alleged that Ernst & Young, hired to review the company's financial statements, was primarily liable because it participated in the creation of publicly released statements, issued a review report, and failed to disclose additional material facts related to the review report. Ernst & Young moved for dismissal on the grounds that it was really being charged with aiding and abetting liability precluded by *Central Bank*. The court denied the motion, concluding that the facts taken as a whole as to Ernst & Young's participation and knowledge could render it liable under a scheme to defraud. *Id.* at 969-72.

In *Adam*, 884 F. Supp. 1398, the plaintiffs alleged that Deloitte & Touche was primarily liable under §10(b) for misrepresentations and "participation in a scheme to defraud" through its involvement with the issuer's press releases and financial statements. *Id.* at 1401. The plaintiffs also alleged that Deloitte knew of the inadequate controls and deviated from conducting its audits in accordance with Generally Accepted Auditing Standards. *Id.* at 1399. The court denied the accounting firm's motion to dismiss because it found that its participation in the preparation of the issuer's statements was part of a scheme to defraud, making the firm primarily liable under Rule 10b-5. *Id.* at 1399-1401. In so holding, the court recognized that Rule 10b-5(b) "essentially outlaws the making of a material misrepresentation or omission," but that subsections (a) and (c) of the Rule "also" outlaw fraudulent schemes and courses of conduct. *Id.* at 1400.

In *In re Union Carbide Corp. Consumer Prods. Bus. Sec. Litig.*, 676 F. Supp. 458, 467-70 (S.D.N.Y. 1987), Morgan Stanley's liability did not depend on whether it "certified or made other public representations about a corporation's allegedly misleading statements"; its "alleged role in knowingly or recklessly preparing the projections could constitute the employment of a 'device, scheme, or artifice to defraud' in violation of 10b-5(1) or an 'act, practice, or course of business which operates or would operate as a fraud or deceit upon any person' in violation of 10b-5(3)."

32 *Aaron*, 446 U.S. at 696 n.13 ("Webster's International Dictionary (2d ed. 1934) defines ... 'scheme' as '[a] plan or program of something to be done; an enterprise; a project; as a business ***scheme*** [,or a] crafty, unethical project ....'") (emphasis in original). To "scheme" is "[t]o form plans or designs; to devise intrigue." *Webster's International Dictionary* 2234 (2d ed. 1934). *The Oxford English Dictionary* 616 (2d ed. 1989) defines "scheme": "A plan, design; a programme of action .... Hence, [a] plan of action devised in order to attain some end; a purpose together with a system of measures contrived for its accomplishment; a project, enterprise." *Black's Law Dictionary* 1344 (6th ed. 1990) defines "scheme": "A design or plan formed to accomplish some purpose; a system."

33 In *Harris v. United States*, 48 F.2d 771 (9th Cir. 1931), for example, "[t]he fraudulent scheme charged ... was one for the sale of [a mining company's] corporate stock ... by the manipulation of the price of the stock on the [stock exchanges] and the circulation of false reports concerning the mine through the mails." *Id.* at 774. "In fact, the whole scheme centered around the establishment of an alleged stock exchange value which is in fact wholly fictitious." *Id.* at 775.

§10(b) was enacted, such conduct already was an unlawful "scheme to defraud" under the mail fraud statute, and today it is called a "fraud-on-the-market" that is actionable under §10(b). *See Basic*, 485 U.S. at 241-47; *Lipton v. Documation, Inc.*, 734 F.2d 740, 744-47 (11th Cir. 1984). Every person who intentionally engages in a "scheme" to defraud is thus ***a primary violator*** of Rule 10b-5 and §10(b).

In *Affiliated Ute Citizens*, 406 U.S. 128, the Court observed that "the second subparagraph of the rule specifies the making of an untrue statement of a material fact and the omission to state a material fact," *id*. at 152-53, but held that "[t]he first and third subparagraphs are not so restricted." *Id*. at 153. It held that the defendants violated Rule 10b-5 when they participated in ***"a 'course of business' or a 'device, scheme, or artifice' that operated as a fraud" – even though these defendants had never themselves said anything that was false or misleading***. *Id*. ***"Not every violation of the anti-fraud provisions of the federal securities law can be, or should be, forced into a category headed 'misrepresentations' or 'nondisclosures.'"*** *Competitive Assocs.*, 516 F.2d at 814. "Fraudulent devices, practices, schemes, artifices and courses of business are also interdicted by the securities laws." *Id.*

Subsections (a) and (c) of Rule 10b-5 thus are aimed at "broader schemes of securities fraud" than are necessarily embodied in a single misleading statement or document, and the "'classic' fraud on the market case [which] ***arises out of transactions on an open and developed market" easily fits within the expansive language of Rule 10b-5(1) and (3)***. *Lipton*, 734 F.2d at 744-45, 747. Thus, the Fifth Circuit sitting *en banc* held that a defendant who did not himself make the statements in a misleading offering circular could be held primarily liable ***as a participant in a larger scheme to defraud of which that offering circular was only a part: "Rather than containing the entire fraud, the Offering Circular was assertedly only one step in the course of an elaborate scheme."*** *Shores*, 647 F.2d at 468.

In *Cooper*, plaintiffs sued Merisel, its officers and directors, its accountants, Deloitte & Touche ***and Lehman Brothers and Robinson-Humphrey, investment banks which served as underwriters of Merisel's public offerings and issued analysts' reports on Merisel***. The complaint alleged that "'[D]efendants falsely presented the Company's current, and future business prospects and prolonged the illusion of revenue and earnings growth by making it appear that the Company's revenue and earnings growth was strong and would continue ....'" 137 F.3d at 620.

Defendants argued that "plaintiffs cannot allege a 'scheme' to defraud, because ***those are conspiracy allegations foreclosed by Central Bank***." *Id.* at 624. However, the Ninth Circuit rejected this argument, stating that the complaint "alleges a 'scheme' in which Merisel and the other defendants directly participated, tracking the language of ***Rule 10b-5(a), which makes it unlawful for any person 'to employ any device, scheme, or artifice to defraud***.'" *Id.* Moreover, "*Central Bank* does not preclude liability based on allegations that a group of defendants acted together to violate the securities laws, as long as each defendant ***committed a manipulative or deceptive act in furtherance of the scheme***." *Id.* Furthermore,

> "[t]he absence of §10(b) aiding and abetting liability does not mean that secondary actors in the securities markets are always free from liability under the securities Acts. ***Any person or entity, including a lawyer, accountant, or bank, who employs a manipulative device or makes a material misstatement (or omission) ... may be liable as a primary violator under 10b-5*** .... In any complex securities fraud, moreover, there are likely to be multiple violators ...."

*Id.* at 624-25.

In *First Jersey*, 101 F.3d at 1471-72, a top First Jersey corporate official who had not made any false statement claimed he should not be held liable under §10(b) of the 1934 Act for an extensive violation of §10(b) and Rule 10b-5 by First Jersey. The Second Circuit stated:

> Brennan contends that even if First Jersey committed fraud, he should not have been held personally liable for any violation ... as a primary violator of the securities law ....
>
> 1. Primary Liability
>
> "Any person or entity ... who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under [federal securities law], assuming all of the requirements for primary liability ... are met." *Central Bank v. First Interstate Bank*, 511 U.S. 164, 191, 128 L. Ed. 2d 119, 114 S. Ct. 1439 (1994) (emphasis omitted). ***Primary liability may be imposed "not only on persons who made fraudulent misrepresentations but also on those who had knowledge of the fraud and assisted in its perpetration***." *Azrielli v. Cohen Law Offices*, 21 F.3d 512, 517 (2d Cir. 1994).
>
> ***The evidence presented at trial sufficed to establish that Brennan had knowledge of First Jersey's frauds and participated in the fraudulent scheme....***

* * *

> In light of the evidence presented at trial with regard to Brennan's hands-on involvement in the pertinent decisions, we conclude that the trial court did not err in finding that Brennan ***knowingly participated in First Jersey's illegal activity and that he should be held primarily liable for its violations of the securities laws.***

*Id.*

And, in fact, many courts have upheld complaints against banks in §10(b)/Rule 10b-5 cases where, as here, false statements, manipulative or deceptive devices, contrivances and acts, and participation in a scheme to defraud have been alleged with sufficient particularity.

In *Murphy v. Hollywood Entm't Corp.*, 1996 U.S. Dist. LEXIS 22207, and *Flecker v. Hollywood Entm't Corp.*, 1997 U.S. Dist. LEXIS 5329, the court refused to dismiss a complaint against investment bankers and then later refused to grant summary judgment to those banks, stating that their "***roles as analysts, investment bankers and business advisors with extensive contacts with [issuer] defendants, superior access to non-public information and participation in both drafting and decision-making is sufficient to establish a triable primary liability claim under § 10(b).***" In initially denying the bank's motion to dismiss, the court recognized that "***any person or entity who directly participates in an alleged violation of § 10(b), even if that person falls within the category of professionals usually deemed 'collateral' participants, may still be liable as a 'primary violator' under § 10(b).***" *Id.* at *20-*21.

In later denying summary judgment, the court noted that the defendants' motive included a "***desire to keep the stock price above $25.50 to avoid having to redeem***" certain shares previously issued in a corporate transaction and that the investment banks "***stood to accrue significant fees.***" *Flecker*, 1997 U.S. Dist. LEXIS 5329, at *14.

> [T]he underwriters ... had long standing close connections to Hollywood such that they either knew or should have known that historical revenues were misstated due to changes in the same store sales base, and that revenue projections were ill-founded given the company's earnings track record as influenced by accounting changes which had the effect of adding revenue to Hollywood's balance sheets and prior earnings per share dividends.

* * *

> Based on the foregoing, I find that defendants' roles as analysts, investment bankers and business advisors with extensive contacts with Hollywood defendants, superior access to non-public information and participation in both drafting and decision-making is sufficient to establish a triable primary liability claim under §10(b).

*Id.* at *20, *25.

*Livent*, 174 F. Supp. 2d 144 shows that a valid §10(b)/Rule 10b-5 claim alleged here. In *Livent*, purchasers of Livent securities sued Livent's investment bank (CIBC) for violations of 1933 Act §11 and 1934 Act §10(b)/Rule 10b-5. The court sustained the adequacy of the §10(b)/Rule 10b-5 claims – finding the bank's participation in "***Livent's fraudulent scheme***" was adequately pleaded. The key allegation against CIBC was that CIBC allegedly made a $4.6 million payment to Livent in return for theatrical royalties, which in reality was a secret "bridge" loan, as CIBC had a side agreement from Livent to repurchase the $4.6 million advance in six months for $4.6 million, plus interest – the "CIBC Wood Gundy Agreement." ***This was a fraudulent contrivance because Livent recorded income on the transaction, but did not record the loan.*** The district court held scienter adequately alleged, stating:

> It does not require an unreasonable inferential leap to conclude, as the Noteholders suggest, that in entering into the bridge loan transaction and secret side agreements with Livent, CIBC, as Livent's investment bankers since 1993, had acquired substantial knowledge of Livent's real financial condition and was aware of Livent's reasons to account for the $4.6 million "non-refundable fee" as a revenue-generating investment rather than a repayable loan....
>
> Significantly, according to the complaint, the proceeds from the alleged fraudulent arrangement were reported by Livent as current revenue in its accounts and public registration statements in order to create a false financial basis to reinforce and ensure the success of Livent securities issues intended in part to repay Livent's substantial debt to CIBC.
>
> From these allegations, ***it is fair to infer that in entering into the CIBC Wood Gundy Agreement, CIBC was aware not only that Livent contemplated marketing securities on the basis of public representations of its financial condition that Livent knew to be false, but that CIBC itself subsequently undertook to solicit and sell the very securities whose value incorporated and was affected by the falsehood CIBC itself had conceived with Livent. In this manner, CIBC's participation in Livent's fraudulent scheme went beyond a passive capacity as Livent's investment banker and financial adviser....***
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> * * *
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> ***The Noteholders have pled facts suggesting that CIBC became part and parcel of Livent's misleading statements by entering into a loan transaction whose true character and financial implications it agreed not to disclose.*** This financial

interest and complicity not only assisted Livent in concealing critical information, it also committed CIBC to similarly withhold the truth from investors with whom it dealt in Livent securities, a commitment that effectively conflicted with any applicable duty CIBC had to disclose material facts in connection with subsequent public sales of such securities affected by the transaction.

***Rather than generally reflecting the profit motive of any securities dealer, the concrete benefit derived by CIBC from Livent's fraud alleged here was uniquely personal to CIBC in several ways. Only CIBC, as Livent's investment bankers since 1993, is alleged to have had a longstanding, intimate relationship with Livent executives that offered it uncommon opportunity to know of, and play an active role in Livent's, financial affairs. And only CIBC is accused, in furtherance of its own motives, of assisting Livent in structuring and keeping secret the misrepresented CIBC Wood Gundy Agreement. Later, in publicly marketing Livent securities whose value partly depended on the true nature of that agreement, CIBC stood to realize gains particular to it. Beyond the standard fees and commissions associated with any investment bank's sales of securities, CIBC had a higher stake in Livent's public financings. It uniquely benefitted from the application of the proceeds of the Notes sales to Livent's considerable debt to CIBC.***

*Id.* at 151-53.

During the ***three*** plus year time period that Enron's financial statements were grossly falsified by hundreds of millions of dollars by Barclays's secret funding of the Chewco/JEDI entity, Barclays participated in the sale of some $2 billion in Enron securities to investors, *i.e.*, a $1.9 billion note offering in 2/01 and was participating in over $4 billion in loans or lending committments to Enron ***Those sales could not have taken place without the falsification of Enron's financial statements that Barclays was participating in***.

Finally, in *Bre-X-Minerals*, 2001 U.S. Dist. LEXIS 4571, the court denied the motion to dismiss by J.P. Morgan based on allegations it participated in a scheme to violate §10(b) and Rule 10b-5 in connection with the securities fraud involving Bre-X. In *Bre-X*, plaintiffs alleged involvement of J.P. Morgan in assisting Bre-X in structuring fraudulent business transactions, acting as Bre-X's financial advisor, and issuing false analysts' reports – ignoring "red flags" that Bre-X's claimed assets were falsified. Thus, J.P. Morgan's motion to dismiss was denied.[34]

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[34] *See also U.S. Envtl.*, 155 F.3d at 112 (while there is no aiding and abetting, where complaint properly alleged defendant to be primary violator because he "'***participated in the fraudulent scheme***,'" noting "***lawyers, accountants, and banks who engage in fraudulent or deceptive*** practices at their client's direction [are] primary violator[s]"); *Scholnick*, 752 F. Supp. at 1323 & n.9 ("bank ... may still be held liable under Rule 10b-5(a) and 10b-5(c) as a participant in the allegedly fraudulent scheme" and "allegations that Continental was directly involved in perpetrating a fraudulent scheme distinguish" this case from situation where bank was only engaging in a "'routine

The CC in this action pleads more wrongful conduct by Barclays vis-à-vis the fraudulent scheme involving Enron and with more specificity than was pleaded in any of the above cases where complaints naming banks as defendants in §10(b)/Rule 10b-5 actions were upheld.

Barclays cannot escape liability by claiming that the illicit Chewco/JEDI SPE contrived transactions do not meet the technical definition of a "manipulative device." It is of no moment that certain cases, purportedly building on *Santa Fe*, 430 U.S. 462, appear to have expressly read into §10(b)'s manipulation language a limited and restrictive congressional intent to simply prohibit such "practices in the marketplace which have the effect of either creating the false impression that certain market activity is occurring when in fact such activity is unrelated to actual supply and demand or tampering with the price itself." *Hundahl v. United Ben. Life Ins. Co.*, 465 F. Supp. 1349, 1360 (N.D. Tex. 1979); *see also Schreiber v. Burlington Northern, Inc.*, 568 F. Supp. 197 (D. Del. 1983); *In re Commonwealth Oil/Tesoro Petroleum Sec. Litig.*, 484 F. Supp. 253 (W.D. Tex. 1979). ***First***, whether or not the SPEs and transactions are technically "market manipulation" devices is academic even under these very cases. The SPE transactions have been pleaded as both contrivances and deceptive devices – and each was clearly deceptive for they falsified Enron financial condition – thereby allowing for Rule 10b-5 scheme liability to attach. *See, e.g., Hundahl*, 465 F. Supp. at 1362 ("Few efforts to play with the price of a traded stock can be successful without running afoul of section 10(b)'s other weapon deception.").[35] ***Second***, *Santa Fe* is not so restrictive as Barclays and certain courts would make it seem. Indeed, the Court clearly expressed its approval of reading the manipulation language of §10(b) broadly by stating: "No doubt Congress meant to prohibit ***the full range of ingenious devices*** that might be used to manipulate securities prices." *Santa Fe*, 430 U.S. at 477.[36] ***Third***, *Santa Fe*, *Hundahl*, *Schreiber* and *Commonwealth Oil/Tesoro* are all clearly off-

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commercial financing transaction'").

[35] Liability under §10(b) and Rule 10b-5 may be imposed for actions either manipulative or deceptive. *See, e.g. Cooper*, 137 F.3d at 624 (each defendant is a primary actor liable under §10(b) "as long as each defendant committed a ***manipulative*** or ***deceptive*** act in furtherance of the ***scheme***").

[36] *See also Santa Fe*, 430 U.S. at 475-76 ("Those cases, forcefully reflect the principle that '[§]10(b) must be read flexibly, ***not technically and restrictively***,' and that the statute provides a cause of action for any plaintiff who 'suffer[s] an injury as a result of deceptive practices touching

point because each case really involved what was merely a state law breach of fiduciary duty cause of action, stemming from a corporate merger or acquisition, dressed up in ill-fitting federal securities law garb.[37] This case is not a mere mismanagement or breach of fiduciary duty case. Without question, it is properly before the court as a federal securities action alleging fraud and deception. No one could plausibly suggest otherwise.

In finding the complaint in *Landry's* did not adequately plead a §10(b) claim against the defendant investment banks there, this court stated:

> Plaintiffs have generally alleged without any particularity that the Underwriters also conducted a comprehensive due diligence investigation into Landry's operations and future prospects in connection with the secondary offering, for which they helped prepare the Registration Statement and Prospectus. They purportedly had access to confidential corporate information and communicated frequently with Fertitta and West about the business, but Plaintiffs fail to provide any details or identify specifically what kind of information, when it was conveyed, by whom and to whom. Plaintiffs have failed to identify any specific information communicated by document or conversations to the Underwriter Defendants or uncovered by them in their due diligence investigation. Instead they have made general statements that might give rise to speculation, but not particularized facts giving rise to a strong inference that the Underwriters acted with severe recklessness or knowingly to support allegations of fraud under the Exchange Act.

*Landry's*, slip op. at 66. The allegations against Barclays in this case are much more detailed than those found wanting in *Landry's*. The specifics regarding Barclays's secret participation in Chewco/JEDI – providing the critical year-end 97funding and continued funding during 98-01 – over $750 million in all – ***to facilitate non-arm's-length fraudulent transactions that enabled Enron to generate hundreds of millions of dollars of phony profits while hiding billions of debt over a three-year period – while requiring secret guarantees and reserve deposits to protect itself because***

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its sale [or purchase] of securities.'"

[37] *See, e.g., Santa Fe*, 430 U.S. at 479-80 ("There may well be a need for uniform federal fiduciary standards to govern mergers such as that challenged in this complaint. But those standards should not be supplied by judicial extension of §10(b) and Rule 10b-5 ...."); *Schreiber*, 568 F. Supp. at 205 ("This case is the perfect example of a plaintiff, who may have nonfrivolous claims based on state law for breach of contract, tortious interference with contract, breach of fiduciary duties and perhaps even conspiracy, attempting to characterize those state law claims as violations of the federal securities laws."); *Commonwealth Oil/Tesoro Petroleum*, 484 F. Supp. at 259 (plaintiffs bringing additional claims for "breach of fiduciary duty" stemming from merger activities); *Hundahl*, 465 F. Supp. at 1362 ("[F]ederalism supports this court's definition of manipulation. The court in *Santa Fe* stated its reluctance to imply a federal cause of action for a claim 'traditionally relegated to state law....' [T]he acts of which plaintiffs complain ... are classic breaches of fiduciary duty.").

***it knew the transactions involved strawmen and were non-arm's-length and fraudulent, Enron distinguishes the pleading here from the one found wanting in Landry's. Here, Barclays secretly took affirmative steps to enable Enron to falsify its financial results and condition. Nothing like that was pleaded in Landry's.***

## V. BARCLAYS ACTED WITH SCIENTER, *I.E.*, WITH "THE REQUIRED STATE OF MIND" AND HAD MOTIVES AND THE OPPORTUNITY TO DEFRAUD ENRON INVESTORS, AS IT MADE FALSE STATEMENTS, EMPLOYED DECEPTIVE ACTS AND MANIPULATIVE DEVICES AND CONTRIVANCES TO DECEIVE AND PARTICIPATED IN A FRAUDULENT SCHEME OR COURSE OF BUSINESS THAT OPERATED AS A FRAUD OR DECEIT ON PURCHASERS OF ENRON SECURITIES

Barclays can claim neither ignorance nor innocence with respect to the Enron debacle. Barclays had an extensive relationship with Enron, during which it gained knowledge of the fraudulent scheme and took affirmative steps to further it. Barclays engaged and participated in the fraudulent scheme and course of business in several ways and in so doing engaged or employed contrivances, devices and acts to deceive. It participated in commercial loans and lending commitments of over $4 billion to Enron. Barclays also helped raise $1.9 billion for Enron via the sales of Enron securities. Barclays's relationships with Enron were so extensive that ***top officials*** of the bank constantly interacted with the very top executives of Enron, *i.e.*, Lay, Skilling, Causey, McMahon or Fastow, on an almost daily basis throughout the Class Period, discussing Enron's business, financial condition, financial needs and plans, partnerships, SPEs and future prospects. Barclays provided ***both*** commercial banking and investment banking services to Enron, Barclays helped structure and fund one of Enron's secretly controlled partnerships/SPEs – JEDI/Chewco – to facilitate illicit and contrived SPE transactions which falsified Enron's financial statements and misrepresented its financial condition. At year-end 97, Barclays funded the fraudulent and non-arm's-length Chewco buyout - requiring a secret no loss guarantee from Enron and a secret multi-million dollar cash deposit – and funded four critical 99 year-end deals to create phony profits for, and hide debt of, Enron. Barclays executives continued to fund Chewco/JEDI during 00-01, while it engaged in repeated non-arm's length deals with Enron to artificially boost its profits by hundreds of millions of dollars, while hiding billions of debt – deceiving the securities markets. As a result of Barclays's participation in the fraudulent scheme, it received huge underwriting and consulting fees, interest payments, commitment fees and other payments from Enron and related entities. ***As alleged, this is intentional participation in the fraud.***

It is clear that for §10(b) or Rule 10b-5 liability to attach under either theory, ***scienter must be present,*** *i.e.*, either intentional or reckless conduct. Thus, with respect to Barclays's alleged deceptive acts and participation in the fraudulent scheme or course of business, scienter would be adequately pleaded if the facts pleaded give rise to a "strong inference" that in committing those acts, Barclays acted with the "required state of mind," *i.e.*, it acted intentionally or recklessly. This would be so even if Barclays made no ***statements*** in Registration Statements that were false and misleading, for as this Court has recognized, ***it is not necessary that a defendant have made a false statement to be liable under §10(b) or Rule 10b-5***. *Landry's*, slip op. at 9 n.12.

A defendant may be held liable for participating in a scheme to defraud if it has knowledge of the scheme and commits manipulative or deceptive acts in furtherance of it.[38] *See BMC Software,* 183 F. Supp. 2d at 885-86, 905, 915; *Cooper*, 137 F.3d at 624 ("*Central Bank* does not preclude liability based on allegations that a group of defendants acted together to violate the securities laws, as long as each defendant committed a manipulative or deceptive act in furtherance of the scheme."); *First Jersey*, 101 F.3d at 1471; *Lemmer v. Nu-Kote Holding, Inc.*, Civ. No. 3:98-CV-0161, 2001 U.S. Dist. LEXIS 13978, at *26-*27 (N.D. Tex. Sept. 6, 2001); *Health Mgmt.*, 970 F. Supp. at 209; *Adam*, 884 F. Supp. at 1401; *ZZZZ Best*, 864 F. Supp. at 967-72. Recklessness satisfies the scienter requirement. *See Nathenson*, 267 F.3d 400.

Whether a defendant has engaged in a scheme to defraud (or whether the complaint has sufficiently alleged so) should be determined by viewing the defendant's conduct (or the allegations of the complaint) ***as a whole***. *See Blackie*, 524 F.2d at 903 n.19 (for scheme liability, complaint should not be fragmented into individual, isolated acts but should be considered as a single overall

[38] We stress that the existence of the scheme and the banks' participation in it are highly factually-dependent questions that either should not be resolved on a motion to dismiss or should be resolved in favor of the plaintiffs. *Richardson*, 451 F.2d at 40 (whether the defendant's conduct amounts to a manipulative or deceptive act "depends upon the facts and circumstances developed at trial").

scheme to defraud); *cf. Affiliated Ute Citizens*, 406 U.S. at 151 ("Congress intended securities legislation enacted for the purpose of avoiding frauds to be construed 'not technically and restrictively, but flexibly to effectuate its remedial purposes.'") (quoting *Capital Gains Research,* 375 U.S. at 186).

It is axiomatic that with respect to scheme liability, a defendant may be liable for participating in a scheme even if it did not interact with all the other participants, was unaware of the identity of each of the other participants, did not know about the specific roles of the other participants in the scheme, did not know about or participate in all of the details of each aspect of the scheme, or joined the scheme at a different time than the other participants. *See United States v. Craig*, 573 F.2d 455, 483-84 (7th Cir. 1977) (scheme to defraud under mail fraud statute); *United States v. Elam*, 678 F.2d 1234, 1246 (5th Cir. 1982) (conspiracy); *United States v. Alvarez*, 625 F.2d 1196, 1198 (5th Cir. 1980) (*en banc*) (conspiracy).[39]

Scheme to defraud and conspiracy liability theories, while they share some similarities, are separate and distinct liability theories and the elements of the two theories are not identical. *See United States v. Read*, 658 F.2d 1225, 1239 (7th Cir. 1981). Most significantly, a conspiracy requires an ***agreement*** and imposes liability based on the act of joining that agreement as well as on acts taken in furtherance of the conspiracy. *See id.* at 1240. A scheme to defraud, on the other hand, requires neither an agreement nor the joining of a scheme; liability is imposed based on using the mails or securities exchanges to further the fraudulent scheme. *See id.* Therefore, if knowledge of all the other details, activities, and participants in a scheme is not essential for conspiracy liability, which requires an agreement among the participants, then such knowledge certainly is not necessary for scheme liability, which does not require an agreement.

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39 As the Supreme Court has stated with respect to conspiracy liability: "[T]he law rightly gives room for allowing the conviction of those discovered [to be participants in a conspiracy] upon showing sufficiently the essential nature of the plan and their connections with it, without requiring evidence of knowledge of all its details or of the participation of others. Otherwise ... conspirators would go free by their very ingenuity." *Blumenthal v. United States*, 332 U.S. 539, 557 (1947).

Plaintiffs cite these conspiracy cases not because they allege conspiracy liability here – they do not. However, since scheme liability is expressly provided for by the language of §10b/Rule 10b-5 and the extent of the scheme liability is ***at least as broad*** a conspiracy liability would be, these conspiracy cases are useful in determining the parameters of scheme liability.

A defendant who participates in a scheme to defraud is liable for the damages caused by all of the acts taken by the participants in the scheme in furtherance of the fraud. *See In re Software Toolworks Sec. Litig.*, 50 F.3d 615, 627-29 & n.3 (N.D. Cal. 1995) (participants in scheme to defraud can be liable for statements made by others in the scheme); *Adam,* 884 F. Supp. at 1401 (same); *ZZZZ Best*, 864 F. Supp. at 968-72 (same); *SEC v. National Bankers Life Ins. Co.*, 324 F. Supp. 189, 194-95 (N.D. Tex.), *aff'd*, 448 F.2d 652 (5th Cir. 1971) (same).[40] A scheme to defraud is a unitary violation, such that the plaintiff need not prove transaction causation with respect to any particular misrepresentations or omissions or other components of the scheme. *See Shores*, 647 F.2d at 469, 472 ("The concept of [a] scheme to defraud satisfies the requirement of 'transaction causation.' It has as its core objective that the potential victim engage in the transaction for which the scheme was conceived."); *Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374, 380-81 (2d Cir. 1974); *ZZZZ Best*, 864 F. Supp. at 973 (to satisfy reliance requirement for scheme liability, it need only be shown that market relied on overall fraudulent scheme rather than on individual statements or omissions).

*National Bankers Life Ins.*, 324 F. Supp. at 193-94 – a pre-*Central Bank* case – recognized that participants in a scheme to defraud under Rule 10b-5 may be held liable for all of the acts involved in the scheme. In that case, the SEC brought an action against 28 defendants for

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40 Similarly, under the federal mail fraud statute, 18 U.S.C. §1341, participants in a scheme to defraud are liable for the acts of the other participants in the scheme, even if the others committed the key acts. *See, e.g., United States v. Humphrey*, 104 F.3d 65, 70 (5th Cir. 1997); *United States v. Lothian*, 976 F.2d 1257 (9th Cir. 1992); *United States v. Maxwell*, 920 F.2d 1028, 1035 (D.C. Cir. 1990); *United States v. Lanier*, 838 F.2d 281, 284 (8th Cir. 1988); *United States v. Wiehoff*, 748 F.2d 1158, 1161 (7th Cir. 1984); *Craig*, 573 F.2d at 483-84.

This principle also applies to conspiracy liability. *See Read*, 658 F.2d at 1231-40 (conspirator liable for acts of co-conspirators even if statute of limitations has run on its own acts); *Dasho v. Susquehanna Corp.*, 380 F.2d 262, 267 n.2 (7th Cir. 1967) (conspirator liable even for acts of co-conspirators occurring after its own last act); *In re Nissan Motor Corp. Antitrust Litig.*, 430 F. Supp. 231, 233 (S.D. Fla. 1977) (conspirator liable even for acts of co-conspirators occurring prior to its joining conspiracy).

The common law also recognized this with respect to contributing tortfeasors or persons acting in concert, such as through a conspiracy or scheme. *See Restatement (Second) of Torts* §875 (1979) ("Each of two or more persons whose tortious conduct is a legal cause of a single and indivisible harm to the injured party is subject to liability to the injured party for the entire harm."); *id.* §876(a) ("For harm resulting to a third person from the tortious conduct of another, one is subject to liability if he (a) does a tortious act in concert with the other or pursuant to a common design with him ...."); *id.* §876, Comment on Clause (a) ("Whenever two or more persons commit tortious acts in concert, each becomes subject to liability for the acts of the others, as well as for his own acts.").

participating in a conspiracy to defraud and a scheme to defraud. *See* 324 F. Supp. at 193-94. Since this was a pre-*Central Bank* case, the SEC did not focus on the difference between conspiracy and scheme liability, treating them essentially as synonymous, and the court did not focus on the difference between primary violators and aiders and abettors, instead assuming that the SEC intended to hold the co-schemers liable as aiders and abettors rather than as primary violators. *See id.* at 195. But although the court considered the scheme liability of the defendants under the rubric of aiding and abetting, it could just as well have considered it under the rubric of primary liability. Nevertheless, the important point is the court's recognition that co-schemers may be liable for all aspects of the scheme:

> In the narrow sense, a defendant could have aided and abetted a particular fraudulent act under 10(b)(5)(2) or 10(b)(5)(3) or use of a particular device under 10(b)(5)(1) and thus be liable for only the results of that specific violation. In the more expansive sense, a defendant could have aided and abetted a ***general scheme*** under 10(b)(5)(1) and ***thus be liable for the results of all aspects of the scheme*** (assuming the scheme was a broad one).

*Id.* at 195.

As noted above, after *Central Bank*, a defendant may be held liable for participating in a scheme to defraud if it has knowledge and commits manipulative or deceptive acts in furtherance of it. Therefore, bringing the principle recognized in *National Bankers Life Ins.* in line with *Central Bank*, if a defendant with knowledge of a broad or general scheme to defraud commits manipulative or deceptive acts in furtherance of broad aspects of the scheme, the defendant may be held liable for all of the results of the scheme. *See generally Central Bank*, 511 U.S. at 191 ("In any complex securities fraud, moreover, there are likely to be multiple violators ....").[41]

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[41] In *Lemmer*, 2001 U.S. Dist. LEXIS 13978, the plaintiffs alleged a scheme to defraud and sought to hold certain of the alleged participants liable for the fraudulent acts of the other participants in the scheme. *See id.* at *25. The court held that, ***on the particular facts of the case before it***, such attribution could not be made because the plaintiffs had failed to sufficiently allege either the existence of the scheme or the defendants' manipulative or deceptive acts in furtherance of it. *See id.* at *26-*27. For example, the sole allegations as to the existence of the scheme were "vague, general, and unsupported by specific details that might support a strong inference of such a scheme." *Id.* at *26. In addition, the complaint made ***no*** allegations regarding the manipulative or deceptive acts of nearly all the defendants in furtherance of the scheme. *See id.* The scheme allegations of the *Lemmer* complaint consisted entirely of the following provision:

> Each of the defendants actually knew the allegedly false statements about Nu-kote's business and future prospects were false and misleading when made. Each of

In evaluating the CC's allegations that Barclays employed acts and manipulative or deceptive devices and contrivances and participated in a fraudulent scheme and course of business, it is important to focus on the ***type*** of actions Barclays is alleged to have committed in furtherance of the alleged fraudulent scheme or course of business. The year-end Chewco/JEDI transactions are by their very nature intentional conduct. These multi-hundred million dollar, highly structured transactions which Barclays entered into with Enron, Chewco/JEDI, and Enron's straw partners at year end, to allow Enron to boost its reported results and hide debt, could not have been the result of negligence or ignorance. Why contrive these deals and require secret guarantees and cash deposits to protect Barclays unless it knew the transactions lacked true economic substance, involved straw men and have been contrived to conceal and deceive, as alleged?

With respect to Barclays's knowledge of false and misleading ***statements*** being made by Enron or others about Enron as part of the scheme to defraud Barclays was participating in, Barclays's alleged conduct, its participating in the fraudulent scheme or course of business, remain highly relevant, for those ***acts*** themselves can show Barclays's ***knowledge*** of the falsity of Enron's statements and financial reports – or its reckless disregard for the truth or falsity – of the ***statements*** it was making.

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> the defendants is liable as a participant in a fraudulent scheme and course of business that operated as a fraud or deceit on purchasers of Nu-kote stock, including false and misleading statements and/or concealed material, adverse facts. The fraudulent scheme and course of business: (a) deceived the investing public regarding Nu-kote's products and business; (b) deceived the commercial markets regarding Nu-kote's success in integrating the Pelikan acquisition and developing new products; (c) created false financial results during the 4thQ of FY96 and the first three quarters of FY97; and (d) caused plaintiff and other members of the Class to purchase Nu-kote stock at inflated prices.

*Id.* at *26-*27. On these facts, the *Lemmer* court concluded that "[a]llowing such general, unsupported allegations of a fraudulent scheme, without any details that support a strong inference of such a scheme such as acts of participation by each of the Defendants, would vitiate the particularity requirements of the PSLRA." *Id.* at *27. In so finding, the court distinguished *Cooper*, 137 F.3d 616, in which the complaint was found to contain sufficient allegations of the defendant's participation in a scheme to defraud to support liability on that basis. *See id.* at *26.

Unlike the complaint in *Lemmer*, and like the complaint in *Cooper*, the CC in this action includes specific, detailed, and substantial allegations concerning both the existence of a scheme to defraud and the banks' participation in it through numerous manipulative and deceptive acts, as set forth above.

For instance, Barclays's involvement in Chewco/JEDI, where it funded ($240 million) the Chewco/JEDI deals to enable Enron to engage in non-arm's-length fraudulent transactions with Enron in the last days of 97 to create bogus income and hide debt, shows that Barclays ***knew (or recklessly disregarded)*** that Enron's financial statements were false, its financial condition was being misrepresented and that its purported business success was not due to strong business conditions or the skill of its managers and the success of their risk management and hedging techniques but rather to non-arm's-length fraudulent financial transactions with controlled entities. During 98-00, as Barclays continued to fund JEDI/Chewco with $500 million more to enable it to continue to do bogus deals with Enron that created hundreds of millions in phony profits and hide billions in debt, Barclays must have known (or recklessly disregarded) that Enron's reported profits and related claims about its financial condition and business success were false.

Assuming these allegations are true, then how was it possible for Barclays not to know the extremely positive statements about the strong economic performance of Enron's various businesses, the skill and talent of its management team, the strength of its core businesses, as well the forecasts of strong continuing earnings growth over the next several years being made by Enron unless Barclays was aware Enron was deliberately lying or Barclays had simply closed its eyes in the blind pursuit of Mammon.

*Livent*, 174 F. Supp. 2d 144, shows that scienter has been well alleged here. In *Livent*, purchasers of Livent securities sued Livent's commercial and investment bank (CIBC) for violations of the 1934 Act – §10(b)/Rule 10b-5. The court sustained the adequacy of the §10(b)/Rule 10b-5 claims – finding the bank's participation in "***Livent's fraudulent scheme***" was adequately pleaded. The key allegation was that CIBC made a $4.6 million payment to Livent in return for theatrical royalties, which in reality was a secret "bridge" loan to Livent, as CIBC had a secret side agreement from Livent to "repurchase" the advance in six months for $4.6 million, plus interest – the "CIBC Wood Gundy Agreement," *i.e.*, a secret guarantee. This was a fraudulent contrivance because Livent recorded income on the transaction, but did not record the loan. The district court held scienter was adequately alleged, stating:

> It does not require an unreasonable inferential leap to conclude, as the Noteholders suggest, that in entering into the bridge loan transaction and secret side agreements with Livent, CIBC, as Livent's investment bankers since 1993, ***had acquired substantial knowledge of Livent's real financial condition and was aware of Livent's reasons to account for the $4.6 million "non-refundable fee" as a revenue-generating investment rather than a repayable loan....*** Significantly, according to the complaint, the proceeds from the alleged fraudulent arrangement were reported by Livent as current revenue in its accounts and public registration statements in order ***to create a false financial basis to reinforce and ensure the success of Livent securities issues intended in part to repay Livent's substantial debt to CIBC.***
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> From these allegations, ***it is fair to infer that in entering into the CIBC Wood Gundy Agreement, CIBC was aware not only that Livent contemplated marketing securities on the basis of public representations of its financial condition that Livent knew to be false, but that CIBC itself subsequently undertook to solicit and sell the very securities whose value incorporated and was affected by the falsehood CIBC itself had conceived with Livent. In this manner, CIBC's participation in Livent's fraudulent scheme went beyond a passive capacity as Livent's investment banker and financial adviser....***
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> * * *
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> ***The Noteholders have pled facts suggesting that CIBC became part and parcel of Livent's misleading statements by entering into a loan transaction whose true character and financial implications it agreed not to disclose.*** This financial interest and complicity not only assisted Livent in concealing critical information, it also committed CIBC to similarly withhold the truth from investors with whom it dealt in Livent securities, a commitment that effectively conflicted with any applicable duty CIBC had to disclose material facts in connection with subsequent public sales of such securities affected by the transaction.
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> ***Rather than generally reflecting the profit motive of any securities dealer, the concrete benefit derived by CIBC from Livent's fraud alleged here was uniquely personal to CIBC in several ways. Only CIBC, as Livent's investment bankers since 1993, is alleged to have had a longstanding, intimate relationship with Livent executives that offered it uncommon opportunity to know of, and play an active role in Livent's, financial affairs. And only CIBC is accused, in furtherance of its own motives, of assisting Livent in structuring and keeping secret the misrepresented CIBC Wood Gundy Agreement. Later, in publicly marketing Livent securities whose value partly depended on the true nature of that agreement, CIBC stood to realize gains particular to it. Beyond the standard fees and commissions associated with any investment bank's sales of securities, CIBC had a higher stake in Livent's public financings. It uniquely benefitted from the application of the proceeds of the Notes sales to Livent's considerable debt to CIBC.***

*Id.* at 151-53. The conduct of Barclays, as alleged here, far exceeds that of CIBC in *Livent*, which was sufficient for the court there to conclude that CIBC's scienter, as well as its participation in Livent's "fraudulent scheme," was adequately pleaded.

In evaluating the CC's allegations of knowledge on the part of Barclays, it is important to appreciate that the banks named as defendants in this case, including Barclays, are very ***different*** financial institutions from the investment banks or commercial banks that may have been named as defendants in prior securities cases. Until recent years, investment banks were ***not*** permitted to engage in commercial bank lending and commercial banks were not permitted to engage in investment banking services. This was the essence of Glass-Steagall. However, when Glass-Steagall was repealed, most banks, including the banks named as defendants in this case, quickly morphed into "financial services institutions" and began to offer both commercial and investment banking services.

This change in the nature of the operations of the banks named as defendants in this case has important implications for the CC's allegations that they knew or were reckless in not knowing that the statements they were making about Enron to investors were false and misleading. Because these banks were making huge commercial loans to Enron, ***as well as*** participating in securities offerings by Enron and related entities, they had much broader and more constant contact with Enron's top executives and access to Enron's non-public financial records, performance and plans then, would have been the case had they only come periodically into contact with Enron to act as an underwriter to sell securities to the public.

During the Class Period, Barclays was a major lender to Enron, being involved in over $4 billion in loans or lending commitments. In making large commercial loans or commitments as Barclays did to Enron, Barclays was required, not only by federal laws and regulations, but by its own internal procedures, ***to engage in an extremely detailed review and analysis of the actual financial condition and creditworthiness of the borrower, not only at the outset when the loan is made, but constantly throughout the pendency of the loan or lending commitment***. Obviously, the larger the size of the loan or loan commitment, the greater the amount of financial analysis oversight and review required. Thus, Barclays was required to perform extensive credit analysis of Enron after obtaining detailed financial information from it. Included in this credit analysis was a detailed review of the Enron's actual and contingent liabilities, its liquidity position, any equity issuance obligations it may have which could adversely affect its shareholders' equity, any debt on which Enron may have been potentially liable, even if not on Enron's books directly, the quality of Enron's profits and earnings and Enron's actual ***liquidity***, including sources of funding to support repayment of any loans. In addition, after Barclays made large loans to or committed itself to credit facilities for a corporation, ***it was required to closely monitor Enron by frequently reviewing its financial condition and ongoing operations for any material changes and insist that top financial officers of the borrower keep it informed of the current status of the borrower's business and financial condition***. As a result, Barclays obtained extremely detailed information concerning the actual financial condition of Enron throughout the Class Period and knew that the actual condition of Enron's business, its finances, and its financial condition was far worse than was being publicly disclosed by Enron. Thus, Barclays knew (or was reckless in not knowing):

(a) Enron had set up Chewco/JEDI at year-end 97 so that Enron could avoid reversal of millions of dollars of previously reported 97 profits and denied having hundreds of millions of dollars of debt put back on its balance sheet and was using Chewco/JEDI on an ongoing basis to engage in non-arm's-length fraudulent transactions with Chewco/JEDI SPEs, which was also permitting Enron to artificially inflate its reported earnings while moving large amounts of debt off its balance sheet during 98-01;

(b) Enron's actual financial condition and results from operations were far worse than what was being publicly disclosed or presented: (i) because Enron was falsifying its financial results and misusing and abusing mark-to-market accounting, resulting in Enron's profitability being far less than publicly reported; (ii) because Enron was improperly moving debt off its balance sheet and onto the balance sheets of entities it secretly controlled, Enron's true debt level and leverage was much higher than what was being publicly presented; and (iii) because of the foregoing, Enron's liquidity and creditworthiness were far worse than publicly known and its financial condition much more leveraged and precarious than was being disclosed to public investors.

In addition to Barclays's extensive, ongoing commercial banking relationship with Enron – and the knowledge it gained from that – Barclays also acted as an underwriter in two Enron securities offerings, raising over $2 billion for Enron before and during the Class Period.

Thus, Barclays had ***constant access*** to Enron's top executives and Enron's financial records, finances, plans, etc. ***in connection with a series of large ongoing major loans and/or lending commitments, as well as securities offerings between 98 and 01***! Thus, this is ***not*** a situation of alleging scienter against a bank that had only isolated contact with an issuer in the context of doing limited due diligence in connection with a single or even periodic securities offerings. Here, what is alleged, is (i) ***constant access by a sophisticated commercial lender to the innermost details of the financial structure and operations of a company that was a major borrower from the commercial operations of the bank, which; (ii) via the bank's investment banking operations was selling securities of the company to the public; and (iii) while the bank was secretly funding a partnership/SPE controlled by the company enabling it to engage in repeated non-arm's-length fraudulent transactions with Enron which were generating hundreds of millions of dollars of phony profits, while hiding billions of dollars of Enron's actual debt***. With all due respect, this is a situation that has never before been presented since the passage of the federal securities laws in 1933-34 because only in recent years have banks been able to engage in the kind of joint commercial and investment banking activity present in this case and which apparently was so abused by them to the great damage of purchasers of Enron's publicly traded securities.

Knowledge is imputed to a corporation through its employees and agents via *respondeat superior*. To determine the *mens rea* of a corporation, courts not only consider the actual knowledge of each individual employee, but also aggregate each employee's knowledge under a theory referred to as the "Collective Knowledge Doctrine."

The Fifth Circuit has clearly found in favor of applying traditional notions of *respondeat superior* to impute knowledge to a corporate defendant in both civil and criminal proceedings. *Standard Oil Co. v. United States*, 307 F.2d 120, 127 (5th Cir. 1962). Furthermore, "'[w]hether the corporate officer or agent was possessed of actual knowledge of facts is ordinarily (a question) of fact for the jury. Whether the knowledge of, or notice to, an officer of a corporation is to be imputed to the corporation is a question of law for the court.'" *American Standard Credit, Inc. v. National Cement Co.*, 643 F.2d 248, 270 (5th. Cir. 1981).

While *Standard Oil* does not limit the imputation of knowledge to high-level employees, [42] subsequent Fifth Circuit cases do appear to focus much more on the employee's position in the company. *See Hellenic Inc. v. Bridgeline Gas Distrib. LLC* (*In re Hellenic Inc.*), 252 F.3d 391, 395 (5th Cir. 2001) ("[W]e have observed that the question of 'privity or knowledge must turn on the facts of the individual case,' stating that a corporation 'is charged with the privity or ***knowledge of its employees when they are sufficiently high on the corporate ladder***.' We have further explained that privity or knowledge 'is imputed to the corporation when the employee is "an executive officer, manager or superintendent whose scope of authority includes supervision over the phase of the business out of which the loss or injury occurred."'").

The First Circuit has detailed the Collective Knowledge Doctrine and its justifications as such:

> [Defendant] Bank contends that the trial court's instructions regarding knowledge were defective because they eliminated the requirement that it be proven that the Bank violated a known legal duty. It avers that the knowledge instruction invited the jury to convict the Bank for negligently maintaining a poor communications network that prevented the consolidation of the information held by its various employees. ***The Bank argues that it is error to find that a corporation possesses a particular item of knowledge if one part of the corporation has half the information making up the item, and another part of the entity has the other half.***
>
> ***A collective knowledge instruction is entirely appropriate in the context of corporate criminal liability.*** *Riss & Company v. United States*, 262 F.2d 245, 250 (8th Cir. 1958); *Inland Freight Lines v. United States*, 191 F.2d 313, 315 (10th Cir. 1951); *Camacho v. Bowling*, 562 F. Supp. 1012, 1025 (N.D. Ill. 1983); United States v. T.I.M.E.-D.C., Inc., 381 F. Supp. 730, 738-39 (W.D. W.Va. 1974); *United States v. Sawyer Transport, Inc.*, 337 F. Supp. 29 (D. Minn. 1971), *aff'd*, 463 F.2d 175 (8th Cir. 1972). The acts of a corporation are, after all, simply the acts of all of its employees operating within the scope of their employment. The law on corporate criminal liability reflects this. *See, e.g., United States v. Cincotta*, 689 F.2d 238, 241, 242 (1st Cir.), *cert. denied*, 459 U.S. 991, 103 S. Ct. 347, 74 L. Ed. 2d 387 (1982); *United States v. Richmond*, 700 F.2d 1183, 1195 n.7 (11th Cir. 1983). ***Similarly, the knowledge obtained by corporate employees acting within the scope of their employment is imputed to the corporation.*** *Steere Tank Lines, Inc. v. United States*, 330 F.2d 719, 722 (5th Cir. 1964). Corporations compartmentalize knowledge, subdividing the elements of specific duties and operations into smaller components.

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42 "***[N]o contention is made that 'knowledge' can be acquired only through supervisory or executive personnel.*** On the contrary, while status of the actor in the corporate hierarchy might well have decisive significance in determining the question we later discuss concerning the intention to benefit the corporation, the corporation may be criminally bound by the acts of subordinate, even menial, employees. ***Likewise, no contention is, or can at this late date, be made that mere violation of instructions would shield the corporation from criminal responsibility for actions which its agents have taken for it.***" *Standard Oil*, 307 F.2d at 127.

> ***The aggregate of those components constitutes the corporation's knowledge of a particular operation. It is irrelevant whether employees administering one component of an operation know the specific activities of employees administering another aspect of the operation***:
>
>> "***[A] corporation cannot plead innocence by asserting that the information obtained by several employees was not acquired by any one individual who then would have comprehended its full import. Rather the corporation is considered to have acquired the collective knowledge of its employees and is held responsible for their failure to act accordingly.***"
>
> *United States v. T.I.M.E.-D.C., Inc.*, 381 F. Supp. at 738. Since the Bank had the compartmentalized structure common to all large corporations, ***the court's collective knowledge instruction was not only proper but necessary***.

*United States v. Bank of New England*, N.A., 821 F.2d 844, 855-56 (1st Cir. 1987).

This district court has explicitly endorsed the Collective Knowledge Doctrine. *See Burzynski v. Aetna Life Ins. Co.*, Civ No. H-89-3976, 1992 U.S. Dist. LEXIS 21300, at *13 (S.D. Tex. Mar. 31, 1992) ("[T]he knowledge of Aetna's agents and employees is imputed to the corporation under the doctrine of '***collective knowledge***.'" (citing *Steere Tank Lines, Inc. v. United States*, 330 F.2d 719,722 (5th Cir. 1963)).[43]

Of course, motive and opportunity remain relevant considerations in determining if scienter has been adequately alleged. Barclays had very strong economic motives to employ acts and contrivances to deceive and participate in the fraudulent scheme or course of business. For instance, the proceeds of Enron's securities offerings underwritten by Barclays or other investment banks were utilized to repay Enron's existing commercial paper and bank indebtedness, including indebtedness to Barclays. And throughout the Class Period, Barclays was pocketing millions of dollars a year in interest payments, syndication fees and investment banking fees by participating in the Enron scheme to defraud and stood to ***continue*** to collect these huge amounts going forward so long as it helped perpetuate the Enron Ponzi scheme, providing it continued access to the capital markets. ¶755.

[43] Additionally, in *American Standard Credit,* 643 F.2d at 271 n.16, the Fifth Circuit stated: "'(T)he general rule is well established that a corporation is charged with constructive knowledge, regardless of its actual knowledge, of all material facts of which its officer or agent receives notice or acquires knowledge while acting in the course of his employment within the scope of his authority, even though the officer or agent does not in fact communicate his knowledge to the corporation.'"

Barclays was willing to engage and participate in the fraudulent scheme and course of business because its participation created enormous profits ***for Barclays as long as the Enron scheme continued in operation*** – something that Barclays was in a unique position to cause. The CC expressly alleges that Barclays was changing premiums unilaterally for its funding of JEDI/Chewco and requiring security loss guarantees and cash deposits to protect itself. It did so due to the fact that it knew the JEDI/Chewco deals with Enron were bogus transactions, lacking true economic substance because (among other things) no independent party in the transactions had capital at risk. And while Barclays was lending hundreds of millions to Enron or had committed to lend hundreds of millions to Enron, it was limiting its own risk in this regard, as it knew that so long as Enron maintained its coveted investment grade credit rating and continued to report strong earnings and credibly forecast strong ongoing revenue and profit growth, ***Enron's access to the capital markets would continue to enable Enron to raise hundreds of millions, if not billions, of dollars of fresh capital from public investors which would be used to repay or reduce Enron's commercial paper debt and the loans from Barclays to Enron so that the scheme could continue.*** ¶755. ***And the longer Enron could be propped up and the Ponzi scheme continue, the longer Barclays could continue to pocket these huge returns*** from such transactions.

Then add to this mix the huge investment banking fees, interest charges, lending commitment fees, etc., Barclays was extracting from Enron by helping to keep the Ponzi scheme going, either lending money to Enron to liquify Enron or by raising money from the public to liquify Enron, and then using money raised from public investors to repay itself or other banks. ***These were huge securities offerings*** –$1.9 billion raised from the sale of 0% convertible notes in 2/01. While the investment banking fees to be gained in an isolated securities offering by an investment bank which does not have an ongoing relationship with the issuer may not, in and of itself, create sufficient weight to show a motive to defraud – surely the size and the continuity of the investment banking fees here, especially when combined with the fees being obtained from the bank's commercial activities must be given great weight vis-à-vis motive. After all, a complaint is to be construed in its entirety and the inferences are to be drawn in favor of the plaintiff.

Barclays claims that it lost money at the end of the day when the Ponzi scheme collapsed. But this argument actually cuts against them. Like a gambler at the craps table who has a long run of good luck, but keeps doubling-up and ends up with a huge amount of chips at work on the table when he finally rolls a seven, Barclays did very, very well for itself and its top executives as long as the run of good luck continued, *i.e.*, the Enron house of cards stood. But, they paid the price when seven came up. In fact, as the financial exposure of the banks to Enron increased as the scheme progressed – ***only increased the motive of the banks, like Barclays, to keep Enron looking good and keep its stock price up so that its increasingly fragile financial structure would not collapse and so that Enron would continue to have access, with the help of the banks, to the capital markets to raise monies to pay back Enron's debts to the bank.***

At the end of the day, the scienter allegations against the banks in this CC are uniquely strong in part because the unique circumstances of this case. The banks named as defendants here chose to vastly expand types of business they did with Enron and types of commercial transactions they engaged in with Enron. In so doing, they entangled themselves in the affairs of the Company that was committing the largest and worst securities fraud in the history of the United States. The banks chose to facilitate and participate in that fraud – and to make false and misleading statements because it gave them – the banks and their top executives – the opportunity to reap huge profits. Having top bank executives and banks secretly invest millions of dollars in partnerships that engage in non-arm's-length fraudulent transactions with a public company to loot it, while creating hundreds of millions of dollars of phony profits and hiding billions of dollars of debt, while the banks were secretly engaging in other bogus transactions with the public company, further artificially boosting its reported earnings and hiding additional billions of dollars of debt and all the while issuing glowing analysts' reports praising the skill and integrity of the Company's management, the tremendous successes of its core businesses, the success of its risk management and hedging techniques, and its wonderful future business and earnings prospects, is simply not banking business as usual. Or if it is, this country and our financial markets are in terrible trouble.

## VI. CONCLUSION

In fact, as this Court knows, a key Arthur Andersen partner condemned the LJM2 partnership – in an e-mail once destroyed, but later resurrected. According to *The New York Times*, 5/10/02 "Andersen Lawyer Accuses Prosecutors of Misconduct":

> [I]n one e-mail message written by Mr. Neuhausen [an Arthur Andersen partner] ... he lambasted Enron's plan to allow its chief financial officer to run a partnership that did business with the company, calling it terrible and asking, "***Why would any director sign off on such a scheme***?"

Indeed. And how could any sophisticated bank have gone in on such a "scheme"? The answer to Neuhausen's question is greed and arrogance – qualities that were present in abundance in Enron's insiders, its outside directors, its lawyers, accountants and banks.

On 2/26/02, *Dow Jones News Service* ran a story headlined: "***Next Stop On Enron Express: Wall Street.***" It noted the "***long gravy train of stock and bond offerings that Enron sent the Streets' way over the past decade.***" It also discussed:

> [T]he now-infamous LJM2 partnership set up by Enron's former chief financial officer, Andrew Fastow. It's been well-documented now ... that high-powered finance firms such as CS First Boston, Merrill Lynch, JP Morgan and Bank America, were lured into the LJM2 partnership by the promise of potentially rich returns and the chance to get an inside peek into Enron's mysterious deals.
>
> * * *
>
> ... ***Wall Street – which got rich touting Enron – is still acting as if it has nothing to answer for in the Enron mess.***
>
> So far, most Wall Street institutions have said little about the Enron debacle, issuing either blanket "no comments," or denying any responsibility for the company's collapse. CS First Boston, which underwrote more than $4.5 billion in Enron stock and bond offerings – roughly 20% of Enron's total underwriting work since 1990 ... has refused to say anything whatsoever. Merrill Lynch, which lined up investors for Fastow's LJM2 partnership and underwrote more than $4 billion in stock and bond offerings for Enron, has been a bit more talkative – ***but only to say it's utterly blameless.***
>
> * * *
>
> Between them, Citigroup and J.P. Morgan served as lead manager on more than $20 billion in syndicated bank loans to Enron over the past decade, with Citigroup also underwriting more than $4 billion in stock and bond offerings for the company ....
>
> ... Wall Street has plenty of explaining to do. Jonathan Kord Lagemann, a securities lawyer and former general counsel for a brokerage firm, says the Enron affair exposes the "***enormous conflict of interest" inherent in these firms' efforts to be three things at one time: underwriter, corporate analyst and stock seller.*** To start, there's

the obvious issue of whether pressure from their firms caused 10 of the 14 research analysts who followed Enron to keep recommending the stock to investors, even as the company was racing toward bankruptcy. A related issue is whether the analysts knew or should've known just how dire the situation was at Enron, since many of them work for firms that were invested in the partnerships that played a critical role in Enron's off-balance-sheet transactions.

¶645. The blatant self-dealing by Enron's banks has not gone unnoticed:

> Many institutional investors declined to buy into LJM2 because of Fastow's conflict of interest. But some of the world's biggest institutions took a piece. Among them ***were CitiGroup, Credit Suisse Group, Deutsche Bank, JP Morgan, and Lehman Brothers.***
>
> ***What were they thinking? Much of the world's financial community turned out to be willing enablers of Enron. No wonder "Wall Street credibility" is fast becoming an oxymoron. Investors are angry ....***

*Business Week*, 2/11/02 (¶648).

The Complaint is not a blunderbuss long winded journey to nowhere. It is a thoroughly investigated detailed blueprint of Barclays's culpability, which states a claim upon which relief can be granted under accepted legal theories.

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Respectfully submitted,


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